TOBACCO SETTLEMENT SECURITIZATION
Reducing Nevada's Revenue Risk for Critical Health and Education Programs

State of Nevada

January 2003—Revised

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The Tobacco Settlement Agreement

- **Annual payments to be made to the State in perpetuity**
  - Payments will be made largely by the “Big Four” tobacco companies (Philip Morris, RJR, Lorillard and Brown & Williamson) based on each company’s annual market share of U.S. cigarette shipments.
  - $221 billion in payments will be made by the “Big Four” over the next 25 years.
  - Annual payments are subject to adjustment based on inflation and changes in volume of U.S. cigarette shipments.
- **The Tobacco Settlement Agreement anticipates that Nevada will receive approximately $1.22 billion over the next 25 years, subject to adjustments for inflation and changes in cigarette consumption.**

Moody’s Investors Service has developed a worst case projection that would result in Nevada’s share being only $996 million over the next 25 years.

Future tobacco settlement payments are unpredictable.

- **Cigarette consumption is dropping faster than anticipated.**
  - The number of cigarettes sold in the U.S. fell a record 3.7% in 2002 as compared to 3% in 1998.
  - Smoking in the U.S. is estimated to decline 2% per year after 2003.
- **Consumption declines are translating into lower tobacco settlement payments.**
- **Strategic bankruptcy by the tobacco companies to protect their assets could result in immediate payment stoppage.**

Over the next 25 years, the rating agency worst-case total payments are $349 million less than currently-projected total payments.

State governments are not well suited to manage exposure to tobacco company risk.

- **Tobacco settlement payments are a long-term receivable from a single industry facing uncertainties on many fronts.**
  - Governments are not equipped to constantly monitor and evaluate uncertainty facing the tobacco industry.
- **The long-term receivable represents a substantial State asset which can be protected by investing in a diversified portfolio.**
  - The State has a fiduciary responsibility to protect and manage its financial assets.
  - For comparative purposes, the General Fund Investment Portfolio of the State is approximately $1.09 billion, which is roughly equivalent to the $1.344 billion the State of Nevada will receive in tobacco settlement payments over the next 25 years.
  - The State of Nevada received $47.4 million in the form of cigarette taxes in Fiscal Year 2002. This amount is significantly higher than the $31.743 million that the State received in the form of MSA payments in Fiscal Year 2002. It is also anticipated that cigarette taxes will be significantly increased during the 2003 legislative session.
- **Decision-makers are caught in the public policy dichotomy of enacting laws to reduce smoking while relying on continued smoking for future revenues.**

State policymakers should be free to take action to reduce smoking without concern for negative revenue impact.

Numerous challenges facing the tobacco industry put future tobacco settlement payments at risk.

- **Litigation**
  - Class actions and punitive damages—***$145 billion Engle award largest in history***
  - Individual smoker cases
  - Third party claims—HMOs, unions
  - Federal government lawsuit
- **Legislation**
  - Possible FDA regulation of tobacco
- **Bankruptcy**
  - Strategic bankruptcy to protect assets from punitive damage awards
- **Future Business Prospects**
  - Public policy initiatives to reduce smoking
  - Additional excise taxes

Stock prices for Philip Morris and Loews Corporation have been volatile over the past five years. Philip Morris and Loews Corporation stock prices are down 8% and 10% in January 2003 from their values in January 1998.

Key Litigation Milestones Over the Next 6–12 Months

	Case/Issue	Likely Impact on Stocks	The "Skinny"
Jan 2003	Lucier verdict	Modestly negative	This case, taking place in Sacramento, will be a barometer of juror attitudes outside of LA or SF. Based on the industry's record thus far, we believe that the industry is likely to face some challenges.
Jan 2003	Scott v. Indus.	Neutral	Trial may begin in this LA medical monitoring class action. Further delays are possible as pending appeals are adjudicated.
Jan 2003	Reller v. PM, B&W	Modestly negative	Trial may be delayed as industry attempts to remove to federal court. Plaintiff is represented by Michael Piuze, counsel to both Bullock and Boeken.
Jan 2003	Harvey v. RJR, PM	Modestly negative	Trial will begin in San Francisco.
Spring 2003	Blue Cross v. Indus. Appeal	Modestly positive	Expect reversal by 2nd Circuit.
Spring 2003	Engle v. Indus. Appeal	Significantly positive	Expect the 3rd DCA in FL to dismantle the $145 billion punitive damage verdict.
Spring 2003	Whiteley v. PM, RJR Appeal	Modestly positive	Expect review of verdict by intermediate appeals court. Decent likelihood that court could reverse and remand for retrial based on Sup. Ct.'s Myers opinion.
Spring/Summer 2003	Simon II	Positive	Expect 2nd Circuit to reverse Weinstein's certification of nationwide Simon II punitive damages class.

Source: Goldman Sachs Research estimates.

Litigation Status Report

Key Dates	Case	Event
January 21, 2003	Miles, et. Al. v. PM	“Lights” class action scheduled for trial in IL state court.
January 21, 2003	Scott v. Industry	Trial scheduled to begin in New Orleans.
January 27, 2003	Harvey v. PM, RJR	Individual smoker in SF.
February 13, 2003	Allen v. PM, RJR	Individual smoker in Miami.

Litigation Status Report (continued)

Key Case	Description	Status and Pending Developments
Engle v. Industry	Individual smoker personal injury class action case	Oral arg. was held on 11/6. Industry put on impressive presentation, focusing on pun. damage size, due process violations, and problems with certification. The 3rd DCA will likely issue an appeal in late-Spring or early Summer. We continue to see a decent probability that the industry could secure at least some measure of victory at the 3rd DCA, if not an entire knock-out win.
Scott v. Industry	Medical monitoring class action case	The LA Sup Ct., ruled that comparative fault would not be an available defense in phase I, clearing the Scott case for trial. The industry is seeking reconsideration of this ruling, which will likely delay the trial until 2003, although it is possible that it could begin by year-end. The industry has won the only other medical monitoring trial it has faced, in the Blankenship case.
DOJ v. Industry	Federal RICO case	Judge Kessler issued an order delaying all dates roughly a year. Summary judgments are now scheduled to filed in Oct. 2003, and trial is scheduled to begin in Sept. 2004. The judge cited complications in discovery as the main reason for the delay.
Simon II	Nationwide class action	On 9/19, Judge Weinstein certified a nationwide punitive damages class of individual smokers. Pltffs estimate that the class could be as large as 5 million people. The industry will appeal this decision within 10 days. We expect that the 2nd Cir. is likely to reverse Weinstein. To date, no Federal appeals court has upheld a certification of individual smokers, let alone a nationwide class. Certification of a nationwide class of smokers has been attempted to no avail at both the state (Engle) and federal (Castano) levels.
Miles, et. al. v. PM	Illinois “Lights” class action	Trial expected to begin in this consumer protection class action, which seeks disgorgement of money spent on light cigarettes. Plaintiffs claim Phillip Morris deceptively marketed these products as health or less-harmful alternatives to full-flavor brands. No punitive damages are involved, and we still believe there are problems with the commonality of the class that could be exposed when the issue of damages is addressed. Trial date could be continued as discovery is continuing.

Litigation Status Report (continued)

Key Case	Description	Status and Pending Developments
Daniels v. Industry Brown v. Industry	Consumer protection class action case	On 9/12, Judge Prager dismissed the Daniels class action on preemption and First Amendment grounds. This ruling may jeopardize the validity of the Brown class action, which is scheduled to go to trial in the Spring of 2003.
Henley v. PM	Further appeal of CA individual case loss	The CA Supreme Court remanded the appeal back to the intermediate court appeals with directions to vacate its prior affirmance, and reconsider the industry's appeal in light of the Myers opinion insulating the industry from liability for conduct during the 10-years from 1988–1998. We think there is decent likelihood that the court of appeals will remand the case for a retrial, since the verdicts were based, at least in part, on conduct that was found to have been non-actionable.
Whiteley v. PM, RJR	Appeal of CA individual case loss	Jury awarded plaintiff $1.7 million in compensatory and $20 million in punitive damages. This appeal had been stayed pending CA Sup. Ct. disposition of the Myers/Naegele appeals. In light of Myers ruling, the appeals court may required additional briefing on the 1988–98 immunity issue, which would delay oral arg. We continue to believe that the industry has a stronger appeal in this case than in Helnley, since Whiteley's factual history is not nearly as strong. We do think there is a decent likelihood that this case could simply be remanded because of the Sup. Ct's opinion in Myers, without the substantive issues being addressed.
Boeken v. PM	Appeal of CA individual case loss	Jury awarded plaintiff $5.5 million in compensatory and $3 billion in punitive damages, which has been cut to $100 by the trial judge. Briefing in this appeal has just began; defendants filed their opening brief on 7/12. We think oral argument is at least a year away. The outcome of the Whiteley appeal, particularly on the immunity question, could dictate what happens in this appeal. We do think there is a decent likelihood that this case could simply be remanded because of the Sup. Ct's opinion in Myers, without the substantive issues being addressed.
Bullock v. PM	Appeal of CA individual case loss	The jury awarded plaintiff $850K in compensatory damages and $28 billion in punitives. The punitive damage award was reduced by the judge to $28 million. The industry will appeal both verdicts, which we estimate could take roughly 2 years.

Litigation Status Report (continued)

Key Case	Description	Status and Pending Developments
Williams-Branch v. PM	Further appeal of OR individual case loss	Oregon Appeals Court affirmed the jury verdict for the plaintiff and reinstated the original $79.5 million punitive damage award that had been cut to $32 million by the trial judge. PM is appealing the loss further to the OR Supreme Court.
Schwartz v. PM	Appeal of OR individual case loss	Jury verdict for the plaintiff $168,000 in compensatory and $150 million in punitive damages, which have been cut to $100 million. PM is appealing the loss to the OR Appeals Court.
Lucier v. PM, RJR	Individual smoker case	Trial began on 11/7, and is expected to end shortly. A key aspect of this case to watch is the extent to which juries in Sacramento behave similar to those in LA and SF. The plaintiffs factual history resembles that of Henley, in that he began smoking before the advent of warning labels. A slight difference to the industry's defense in this case is that they are alleging that Lucier's cancer originated elsewhere in his body and metastasized to his lung.
Harvey v. RJR & PM	Individual smoker case	Ind. Has made a motion to postpone trial, pending resolution of the Simon II nationwide class action, since, by definition of that class, Harvey is a member and cannot litigate his claims until that case has been resolved. A similar motion was made and denied in Lucier. The trial postponed until 1/27/03.

Source: Company reports, Goldman Sachs Research estimates.

Tobacco Settlement Overview

- The Tobacco Settlement Agreement provides Nevada with annual payments in perpetuity, adjusted for inflation and changes in the volume of cigarette sales.
- Tobacco settlement payments are dedicated to funding critical State health and education programs by Nevada law.
- The tobacco industry is facing uncertainty from litigation, bankruptcy risk and future business prospects.
- Future tobacco settlement payments are subject to extreme fluctuation and possible stoppage.

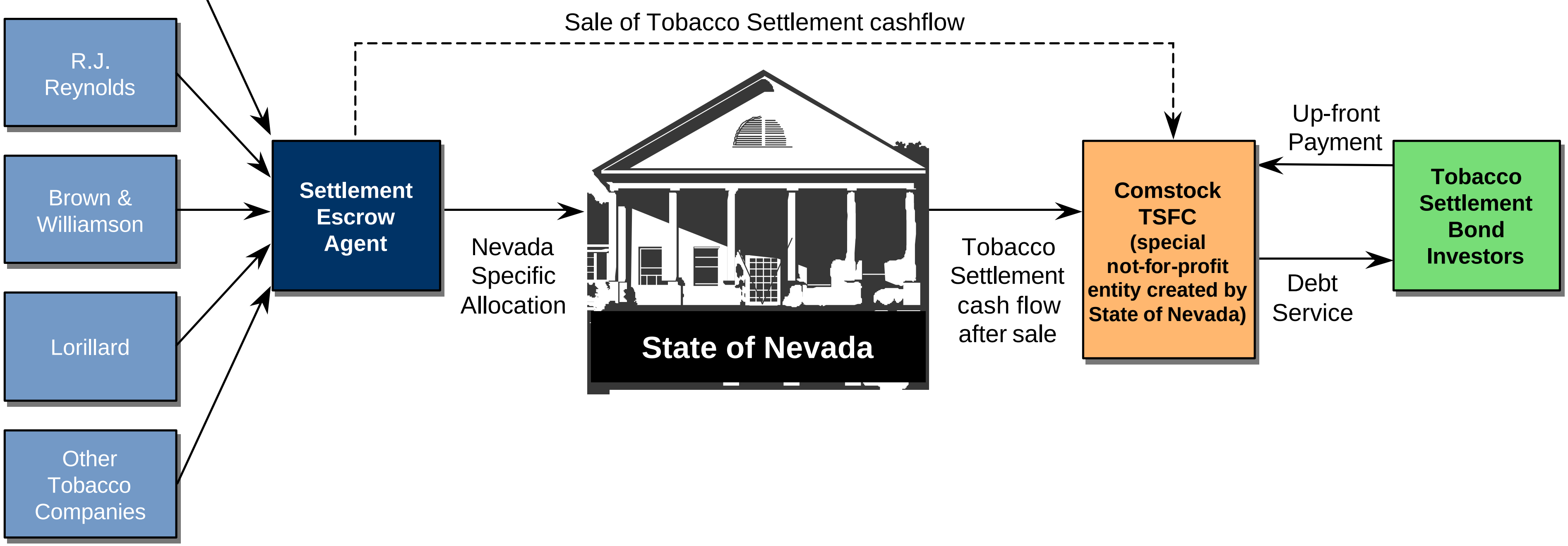
How a Securitization Works

- Securitization provides the State with a method of managing the risk inherent in receiving payments from the tobacco companies—proceeds from the securitization would be invested to provide a more secure revenue source for funding Nevada’s health and education programs.

- The owner (State) of a contractually obligated payment stream (Tobacco Settlement Payments) sells the payment stream to a special purpose entity—the Comstock Tobacco Settlement Financing Corporation (TSFC)—in exchange for an up-front payment.

- The TSFC issues bonds backed solely by the purchased payment stream.
  - No recourse to seller

How a Securitization Works



Financial Impact of Securitization

- **Financial analysis compares two alternatives:**

  (1) Spend-as-received funding for Nevada's programs.

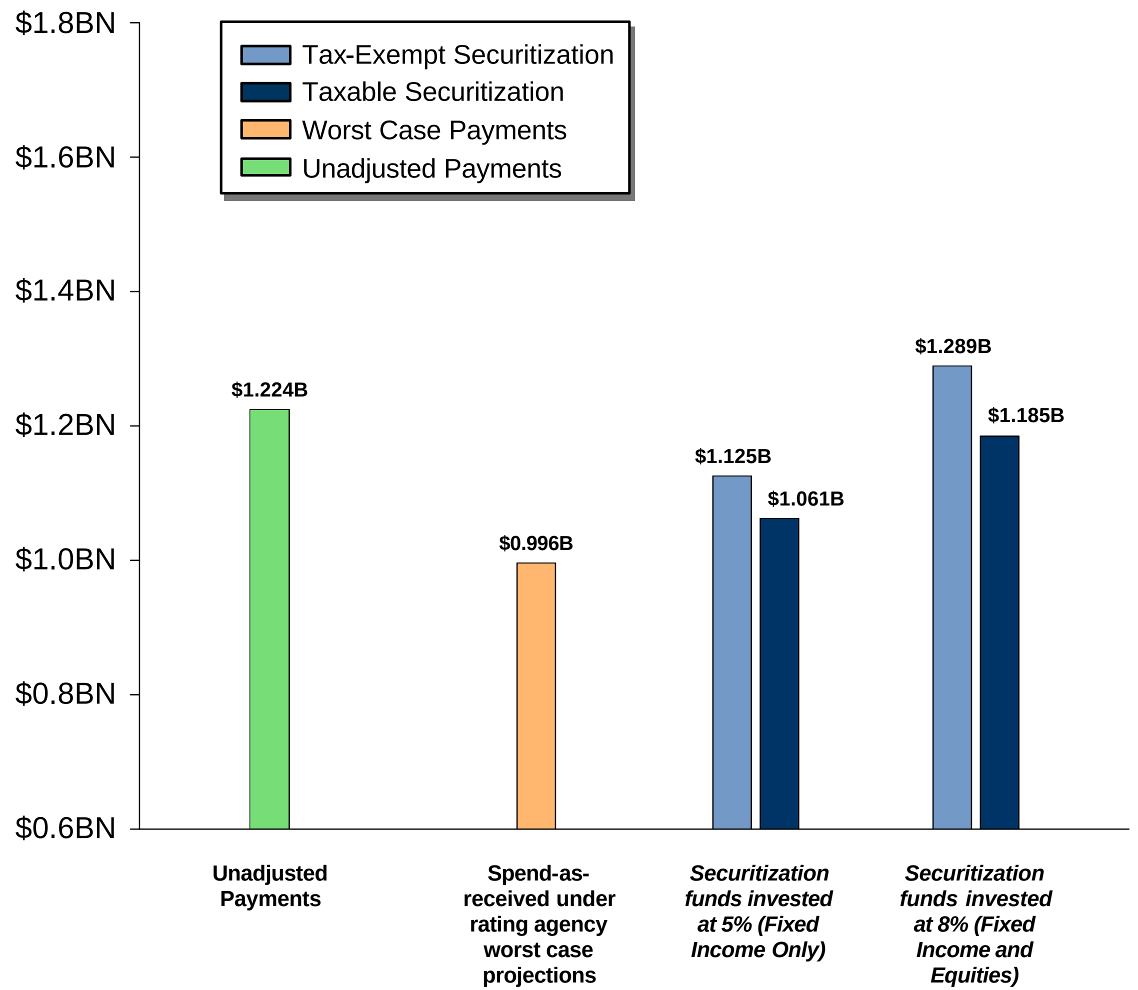
  (2) Securitization funds invested in a trust fund that produces a pre-specified annual amount for Nevada's programs.

- **Key conclusions**

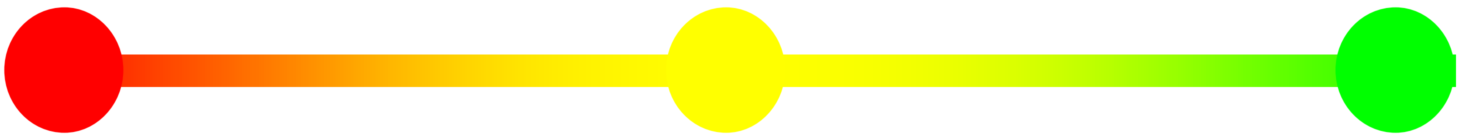
  - The Legislature, by allowing the Treasurer to invest in a diversified portfolio, has the ability to improve the results and achieve higher investment returns.

  - Projections of spend-as-received funding must be measured against the substantial risks of tobacco settlement payments.

Funds Available for Programs Over 25 Years



Nevada has a wide range of options to consider.



No Securitization

+ No interest costs paid
+ More dollars if consumption decline is less than projected
– Continuing uncertainty of payment amounts
– Maximum exposure to tobacco companies

Partial Securitization

+ Reduced interest costs
+ Reduced exposure to tobacco companies
– Continuing uncertainty of payment amounts
– Continuing exposure to tobacco companies

Full Securitization

+ Greatest risk transfer to investors
+ Highest level of payment certainty
+ Minimizes exposure to tobacco companies
– Interest costs

Securitization will be the most reliable method for ensuring that Nevada receives its share of tobacco settlement.

Before Securitization

- Future tobacco settlement payments are subject to substantial fluctuations and at risk of complete stoppage.
- The State is not well suited to monitor and evaluate tobacco company risk. The State is also not able to quickly respond to negative changes in the industry.
- The Legislature would have to weigh actions to reduce smoking with concern for the potential revenue impact.

After Securitization

- *The State will not be dependent on the tobacco settlement revenues for funding critical programs.*
- *The asset represented by the tobacco settlement is diversified by investing securitization funds in the broader market.*
- *The Legislature is free to take action to reduce smoking without concern for the potential revenue impact.*

After securitization, the State will be able to focus on managing tobacco settlement payments and avoid the risk associated with the tobacco industry.

Legislation to authorize securitization should protect the State and provide appropriate security provisions to minimize financing costs.

- **Summary of key provisions of securitization bill:**

1. Authorize creation by designated State officials of a new not-for-profit corporation to issue bonds, notes or other debt instruments for purposes provided below.
2. Authorize State Treasurer to transfer State's right to receive tobacco settlement proceeds to the not-for-profit corporation in exchange for proceeds of bonds and to make such covenants on behalf of the State as are necessary so that the corporation continues to be entitled to receive tobacco settlement monies under the terms of the settlement.
3. Authorize the new not-for-profit corporation to issue bonds and other securities payable solely from the tobacco settlement monies and to enter into all necessary or desirable contracts in connection therewith, including professional service contracts, credit enhancement contracts and interest rate hedge contracts. Provide such securities that shall never be a debt or indebtedness of the State.
4. Authorize the corporation to enforce the tobacco settlement and the State to join in any such enforcement action if necessary.
5. Require the net proceeds of any such bonds or the proceeds from the sale of the rights to the settlement monies to the new not-for-profit corporation be deposited in the funds established by the legislature.
6. Authorize the Treasurer to invest monies in those funds in any securities which would be permitted investments for the State Treasurer under Chapter 355 of NRS and in all other investments, including equity investments, which can be made with monies in the public employees' retirement fund pursuant to NRS §286.680 and §286.682.
7. Provide that the State, its officers, employees and agents and the corporation, its officers, employees and agents are immune from any lawsuit on account of any act or omission by those officers or employees (whether it would be otherwise actionable under federal or State law), `except that the corporation and the State may be required, in an action for specific performance, to comply with the provisions of their respective contracts with respect to the bonds and the transfer of the rights to the tobacco settlement.
8. Provide that on dissolution or retirement of the bonds and any refunding bonds, any remaining assets of the corporation must revert to the State, to be applied in the same manner, as tobacco settlement monies are required to be applied as established by the legislature.
9. In order to permit the tobacco securitization bonds to be tax-exempt, the Legislature may need to authorize certain budgetary procedural changes to permit securitization proceeds to be traceable to capital expenditures or near-term debt repayment.

Nevada's Tobacco Settlement Payments

State of Nevada

	Unadjusted Payments (Nevada's Portion of Initial, Annual and Strategic Payments)	Present Value of Unadjusted Payments Discounted at 7%	Present Value of Unadjusted Payments Discounted at 9%
2003	51,185,578	51,185,578	51,185,578
2004	42,719,854	39,879,441	39,119,850
2005	42,719,854	37,227,885	35,823,218
2006	42,719,854	34,752,629	32,804,394
2007	42,719,854	32,441,951	30,039,966
2008	51,353,215	36,405,260	33,067,757
2009	51,353,215	33,984,700	30,281,135
2010	51,353,215	31,725,081	27,729,342
2011	51,353,215	29,615,703	25,392,589
2012	51,353,215	27,646,575	23,252,755
2013	51,353,215	25,808,374	21,293,244
2014	51,353,215	24,092,393	19,498,861
2015	51,353,215	22,490,507	17,855,691
2016	51,353,215	20,995,129	16,350,991
2017	51,353,215	19,599,177	14,973,092
2018	48,819,205	17,393,229	13,034,728
2019	48,819,205	16,236,765	11,936,291
2020	48,819,205	15,157,194	10,930,419
2021	48,819,205	14,149,403	10,009,312
2022	48,819,205	13,208,619	9,165,827
2023	48,819,205	12,330,387	8,393,423
2024	48,819,205	11,510,548	7,686,108
2025	48,819,205	10,745,220	7,038,400
2026	48,819,205	10,030,778	6,445,273
2027	48,819,205	9,363,838	5,902,130
Total	***1,223,789,194***	***597,976,364***	***509,210,377***

- **Three types of payments:**
  - Initial Payments: 2000–2003
  - Annual Payments: 2000–Perpetuity
  - Strategic Contribution Payments: 2008–2017
- **Annual and Strategic Contribution Payments are adjusted for:**
  - Inflation at 3% minimum
  - Volume changes
  - Previously Settled States' Payments and Subsequent Participating Manufacturers payments

Global Insight (formerly DRI-WEFA) updates forecasts for each new tobacco issuance.

	Base Case 1999	Base Case 2003	% Change
2003	$47,051,132	$46,060,311	-2.11%
2004	41,372,717	40,040,632	-3.22%
2005	41,832,917	40,562,250	-3.04%
2006	42,146,401	41,225,333	-2.19%
2007	42,403,666	41,853,944	-1.30%
2008	51,333,375	51,072,988	-0.51%
2009	51,767,889	51,836,976	0.13%
2010	52,388,187	52,524,376	0.26%
2011	52,927,478	53,273,917	0.65%
2012	53,418,703	54,023,848	1.13%
2013	53,838,123	54,736,050	1.67%
2014	54,213,144	55,430,701	2.25%
2015	54,513,206	56,112,479	2.93%
2016	55,205,831	56,904,115	3.08%
2017	55,845,670	57,695,981	3.31%
2018	53,701,118	55,579,941	3.50%
2019	54,317,472	56,315,459	3.68%
2020	54,941,642	57,033,124	3.81%
2021	55,504,126	57,817,340	4.17%
2022	56,293,064	58,595,555	4.09%
2023	56,989,900	59,408,119	4.24%
2024	57,613,166	60,220,649	4.53%
2025	58,287,175	61,104,748	4.83%
2026	59,255,604	61,996,252	4.63%
2027	60,291,826	62,907,446	4.34%
	$1,317,453,532	$1,344,332,536	2.04%

Nevada's Tobacco Settlement Payments with Projected Adjustments

- **WEFA, Inc., a well-regarded econometrics consulting firm also used by the State of Nevada, has forecasted changes in cigarette consumption for all securitizations completed to date based on a wide range of factors including:**
  - Price increases
  - Income growth
  - Increased anti-smoking initiatives
- **One of the major rating agencies (Moody's) has provided their worst case scenario for declining cigarette consumption, which will be used for structuring securitization transactions.**

Adjusted Payments

Year	Unadjusted Payments	2003 WEFA Base Case	Present Value of WEFA Base Case at 7%	Present Value of WEFA Base Case at 9%	Rating Agency Worst Case (Moody's)	Present Value of Rating Agency Worst Case at 7%	Present Value of Rating Agency Worst Case at 9%
2003	51,185,578	46,060,311	46,060,311	46,060,311	45,272,024	45,272,024	45,272,024
2004	42,719,854	40,040,632	37,378,359	36,666,406	38,734,711	36,159,267	35,470,535
2005	42,719,854	40,562,250	35,347,658	34,013,935	38,342,033	33,412,867	32,152,147
2006	42,719,854	41,225,333	33,536,835	31,656,758	37,954,989	30,876,408	29,145,474
2007	42,719,854	41,853,944	31,784,369	29,431,071	37,573,550	28,533,788	26,421,162
2008	51,353,215	51,072,988	36,206,602	32,887,311	44,709,133	31,695,146	28,789,448
2009	51,353,215	51,836,976	34,304,845	30,566,392	44,264,060	29,293,215	26,100,917
2010	51,353,215	52,524,376	32,448,603	28,361,738	43,825,641	27,074,683	23,664,657
2011	51,353,215	53,273,917	30,723,383	26,342,318	43,393,854	25,025,492	21,456,929
2012	51,353,215	54,023,848	29,084,340	24,462,018	42,968,673	23,132,664	19,456,231
2013	51,353,215	54,736,050	27,508,471	22,695,912	42,550,080	21,384,219	17,643,087
2014	51,353,215	55,430,701	26,005,349	21,047,086	42,138,055	19,769,095	15,999,857
2015	51,353,215	56,112,479	24,574,861	19,510,504	41,732,581	18,277,081	14,510,563
2016	51,353,215	56,904,115	23,264,546	18,118,412	41,333,642	16,898,750	13,160,734
2017	51,353,215	57,695,981	22,019,922	16,822,457	40,941,225	15,625,396	11,937,261
2018	48,819,205	55,579,941	19,801,933	14,839,845	38,558,004	13,737,384	10,294,988
2019	48,819,205	56,315,459	18,729,942	13,769,125	38,197,284	12,704,024	9,339,233
2020	48,819,205	57,033,124	17,707,419	12,769,482	37,842,739	11,749,264	8,472,834
2021	48,819,205	57,817,340	16,757,357	11,854,184	37,494,362	10,867,093	7,687,401
2022	48,819,205	58,595,555	15,853,727	11,001,341	37,152,151	10,051,958	6,975,333
2023	48,819,205	59,408,119	15,004,855	10,213,961	36,816,104	9,298,734	6,329,745
2024	48,819,205	60,220,649	14,198,771	9,481,155	36,486,223	8,602,689	5,744,400
2025	48,819,205	61,104,748	13,449,296	8,809,640	36,162,510	7,959,452	5,213,649
2026	48,819,205	61,996,252	12,738,238	8,184,951	35,844,971	7,364,990	4,732,372
2027	48,819,205	62,907,446	12,066,054	7,605,366	35,533,612	6,815,576	4,295,932
Total	**1,223,789,194**	**1,344,332,536**	**626,556,045**	**527,171,678**	**995,822,209**	**501,581,258**	**430,266,912**

Assumptions

	WEFA	Rating Agency Worst Case
Inflation	3.000%	3.000%
1999 Actual Volume Decline	(8.744%)	(8.744%)
2000 Volume Decline	(1.150%)	(1.150%)
Average Volume Decline 2003-2027	(1.637%)	(4.000%)
Cumulative Volume Decline 2027	(42.582%)	(70.514%)

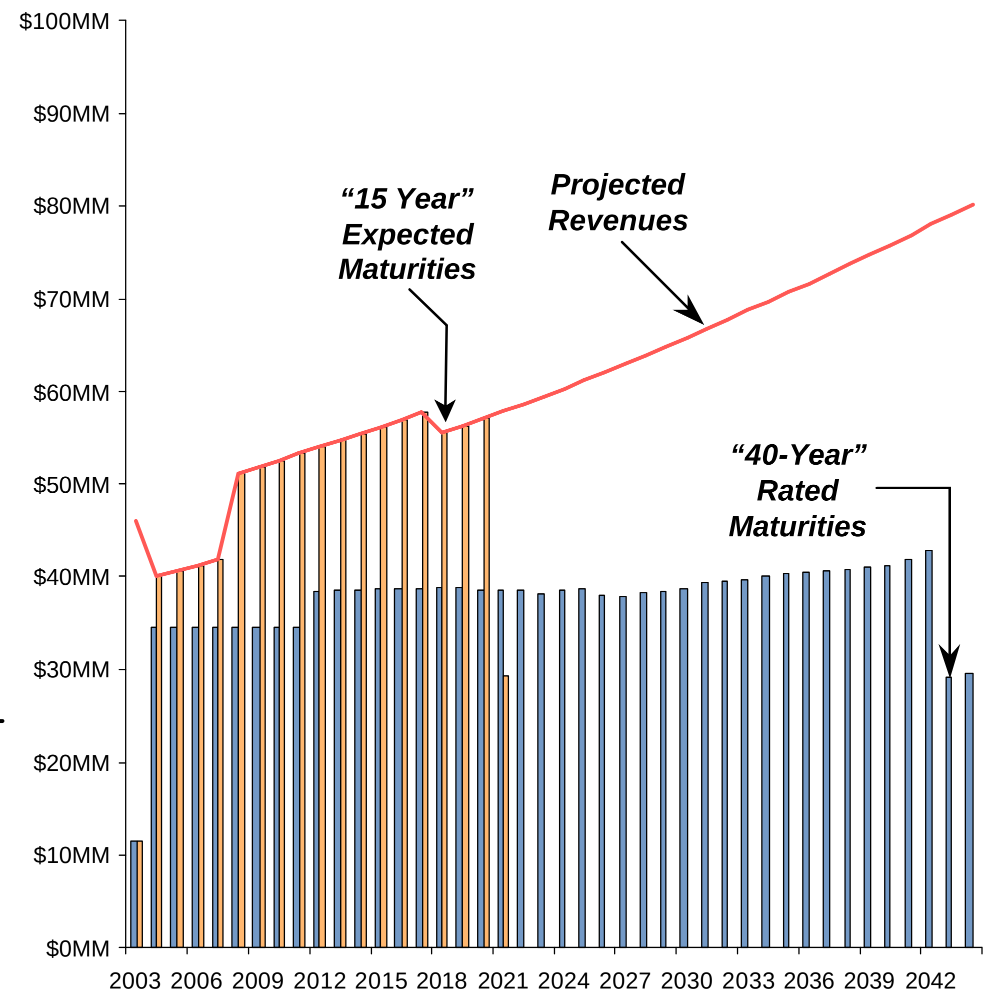
If a tax-exempt structure is used, securitization will generate approximately $458 million up-front for the State's programs.

- The tax-exempt analysis is applicable if the Legislature authorizes the State and its Agencies permitting the tobacco securitization payments to be traceable to items such as capital expenditures or near term debt repayment.
- In a securitization, the State sells the right to receive all or a portion of the settlement revenues to an independent corporation, which will issue bonds to pay the purchase price.
- Investors buy the bonds and set the interest rate based on their view of the likelihood of timely repayment including a thorough review of ratings, debt service coverage levels and reserves.
- Under a structure in which every dollar received from the securitized portion of the settlement is used to pay down the debt as fast as possible, tobacco securitization transactions are expected to be repaid over 15 years, but the rating agencies allow payment to be extended over 40 years before a default occurs.

Securitization Results

Bond Proceeds:	$493,495,000
Reserves:	(35,000,000)
Proceeds Available to State:	***$458,495,000***

Tax-Exempt Securitization Debt Structure[(a)]



(a) Assumes 7% bond interest rate.

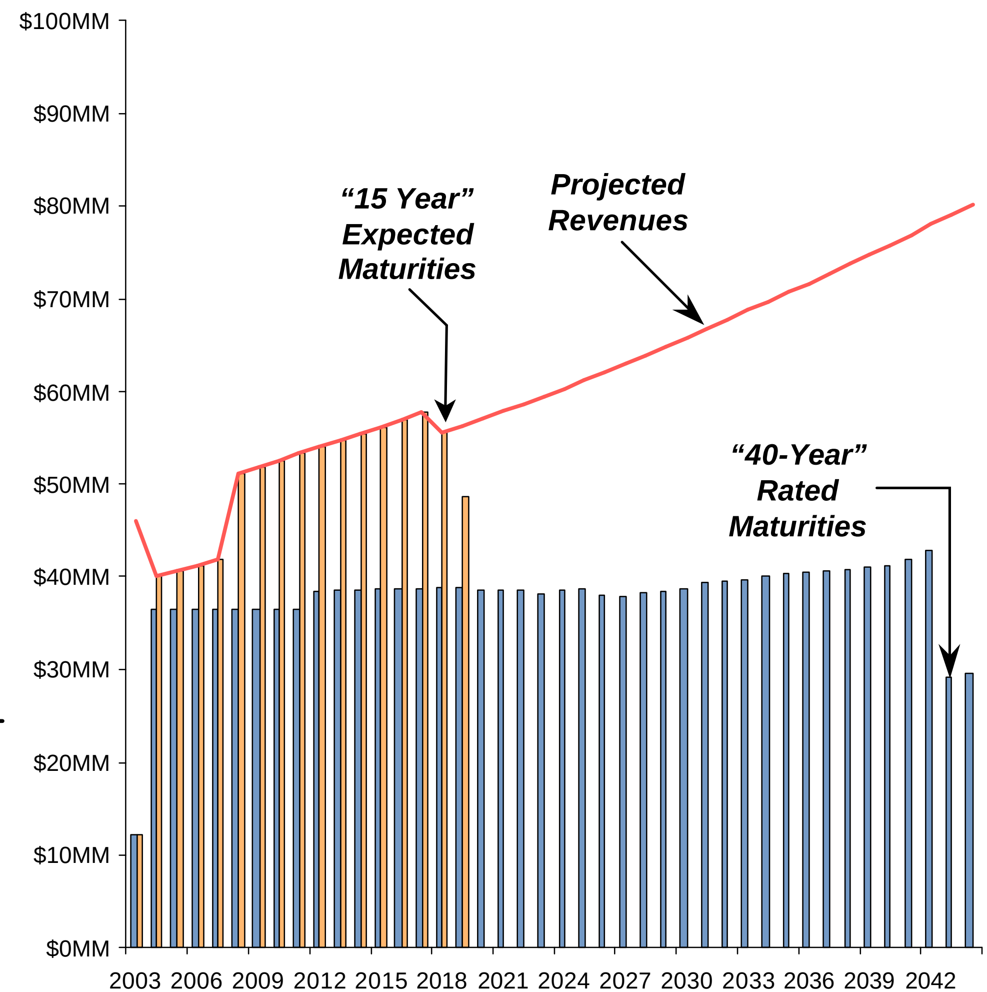
If a taxable structure is used, securitization will generate approximately $369 million up-front for the State's programs.

- If the Legislature does not take action permitting expenditures of tobacco securitization proceeds for "tax-exempt purposes", and instead, the money is directly deposited in taxable investments the securitization borrowing must be taxable.
- In a securitization, the State sells the right to receive all or a portion of the settlement revenues to an independent corporation, which will issue bonds to pay the purchase price.
- Investors buy the bonds and set the interest rate based on their view of the likelihood of timely repayment including a thorough review of ratings, debt service coverage levels and reserves.
- Under a structure in which every dollar received from the securitized portion of the settlement is used to pay down the debt as fast as possible, tobacco securitization transactions are expected to be repaid over 15 years, but the rating agencies allow payment to be extended over 40 years before a default occurs.

Securitization Results

Bond Proceeds:	$404,665,000
Reserves:	(36,000,000)
Proceeds Available to State:	***$368,665,000***

Taxable Securitization Debt Structure[a]



(a) Assumes 9% bond interest rate.

Investment earnings on securitization proceeds will affect the level of funds available annually for State programs.

- **The following pages analyze a variety of scenarios for both tax-exempt and taxable structures:**

Case I:	Securitization proceeds invested at 5% (Fixed Income Only)
Case II:	Securitization proceeds invested at 8% (Fixed Income and Equities)
Case III:	Securitization proceeds invested at 5% and expended pro-rata over the life of the bond issue
Case IV: **(State Treasurer's Recommendation)**	Securitization proceeds invested at 8% and expended pro-rata over the life of the bond issue
Case V:	Securitization proceeds invested at 5% and expended rapidly to provide same annual cash flow as adjusted payments
Case VI: **(State Treasurer's Recommendation)**	Securitization proceeds invested at 8% and expended rapidly to provide same annual cash flow as adjusted payments

In every case, the State will receive a residual after the bonds are paid off that can be securitized again, or annual tobacco payments to the State will be resumed.

Case I: Tax-Exempt Securitization Proceeds Invested at 5% (Fixed Income)

Annual Cash Flow Analysis at 5% Earnings

Year	2003 WEFA Base Case	Rating Agency Worst Case Adjusted Payments	Securitization Proceeds	Earnings at 5%	Residual	*ANNUAL CASH FLOW*
2003	$46,060,311	$45,272,024	$458,495,000	$22,924,750	—	***$22,924,750***
2004	40,040,632	38,734,711	—	22,924,750	—	***22,924,750***
2005	40,562,250	38,342,033	—	22,924,750	—	***22,924,750***
2006	41,225,333	37,954,989	—	22,924,750	—	***22,924,750***
2007	41,853,944	37,573,550	—	22,924,750	—	***22,924,750***
2008	51,072,988	44,709,133	—	22,924,750	—	***22,924,750***
2009	51,836,976	44,264,060	—	22,924,750	—	***22,924,750***
2010	52,524,376	43,825,641	—	22,924,750	—	***22,924,750***
2011	53,273,917	43,393,854	—	22,924,750	—	***22,924,750***
2012	54,023,848	42,968,673	—	22,924,750	—	***22,924,750***
2013	54,736,050	42,550,080	—	22,924,750	—	***22,924,750***
2014	55,430,701	42,138,055	—	22,924,750	—	***22,924,750***
2015	56,112,479	41,732,581	—	22,924,750	—	***22,924,750***
2016	56,904,115	41,333,642	—	22,924,750	—	***22,924,750***
2017	57,695,981	40,941,225	—	22,924,750	—	***22,924,750***
2018	55,579,941	38,558,004	—	22,924,750	—	***22,924,750***
2019	56,315,459	38,197,284	—	22,924,750	—	***22,924,750***
2020	57,033,124	37,842,739	—	22,924,750	—	***22,924,750***
2021	57,817,340	37,494,362	—	22,924,750	$28,435,140	***51,359,890***
2022	58,595,555	37,152,151	—	22,924,750	58,595,555	***81,520,305***
2023	59,408,119	36,816,104	—	22,924,750	59,408,119	***82,332,869***
2024	60,220,649	36,486,223	—	22,924,750	60,220,649	***83,145,399***
2025	61,104,748	36,162,510	—	22,924,750	61,104,748	***84,029,498***
2026	61,996,252	35,844,971	—	22,924,750	61,996,252	***84,921,002***
2027	62,907,446	35,533,612	—	22,924,750	62,907,446	***544,327,196***
Total	**$1,344,332,536**	**$995,822,209**	**$458,495,000**	**$573,118,750**	**$392,667,909**	***$1,424,281,659***

- The securitization proceeds are invested and remain available after the bonds are paid off.

Case II: Tax-Exempt Securitization Proceeds Invested at 8% (Fixed Income and Equities)

Annual Cash Flow Analysis at 8% Earnings

Year	2003 WEFA Base Case	Rating Agency Worst Case Adjusted Payments	Securitization Proceeds	Earnings at 8%	Residual	*ANNUAL CASH FLOW*
2003	$46,060,311	$45,272,024	$458,495,000	$36,679,600	—	***$36,679,600***
2004	40,040,632	38,734,711	—	36,679,600	—	***36,679,600***
2005	40,562,250	38,342,033	—	36,679,600	—	***36,679,600***
2006	41,225,333	37,954,989	—	36,679,600	—	***36,679,600***
2007	41,853,944	37,573,550	—	36,679,600	—	***36,679,600***
2008	51,072,988	44,709,133	—	36,679,600	—	***36,679,600***
2009	51,836,976	44,264,060	—	36,679,600	—	***36,679,600***
2010	52,524,376	43,825,641	—	36,679,600	—	***36,679,600***
2011	53,273,917	43,393,854	—	36,679,600	—	***36,679,600***
2012	54,023,848	42,968,673	—	36,679,600	—	***36,679,600***
2013	54,736,050	42,550,080	—	36,679,600	—	***36,679,600***
2014	55,430,701	42,138,055	—	36,679,600	—	***36,679,600***
2015	56,112,479	41,732,581	—	36,679,600	—	***36,679,600***
2016	56,904,115	41,333,642	—	36,679,600	—	***36,679,600***
2017	57,695,981	40,941,225	—	36,679,600	—	***36,679,600***
2018	55,579,941	38,558,004	—	36,679,600	—	***36,679,600***
2019	56,315,459	38,197,284	—	36,679,600	—	***36,679,600***
2020	57,033,124	37,842,739	—	36,679,600	—	***36,679,600***
2021	57,817,340	37,494,362	—	36,679,600	$28,435,140	***65,114,740***
2022	58,595,555	37,152,151	—	36,679,600	58,595,555	***95,275,155***
2023	59,408,119	36,816,104	—	36,679,600	59,408,119	***96,087,719***
2024	60,220,649	36,486,223	—	36,679,600	60,220,649	***96,900,249***
2025	61,104,748	36,162,510	—	36,679,600	61,104,748	***97,784,348***
2026	61,996,252	35,844,971	—	36,679,600	61,996,252	***98,675,852***
2027	62,907,446	35,533,612	—	36,679,600	62,907,446	***558,082,046***
Total	**$1,344,332,536**	**$995,822,209**	**$458,495,000**	**$916,990,000**	**$392,667,909**	***$1,768,152,909***

- Securitization proceeds invested at 8% will produce $1.768 billion over 25 years vs. a range of $996 million to $1.344 billion without securitization.

Case III: Tax-Exempt Securitization Proceeds Invested at 5% and Expended Over the Life of the Bond Issue

Annual Cash Flow Analysis at 5% Earnings

Year	2003 WEFA Base Case	Rating Agency Worst Case Adjusted Payments	Securitization Proceeds	Outflow of Securitization Proceeds	Earnings at 5%	Residual	*ANNUAL CASH FLOW*
2003	$46,060,311	$45,272,024	$458,495,000	—	$22,924,750	—	***$22,924,750***
2004	40,040,632	38,734,711	453,389,720	$5,105,280	22,669,486	—	***27,774,766***
2005	40,562,250	38,342,033	447,443,626	5,946,095	22,372,181	—	***28,318,276***
2006	41,225,333	37,954,989	440,466,255	6,977,370	22,023,313	—	***29,000,683***
2007	41,853,944	37,573,550	432,415,800	8,050,455	21,620,790	—	***29,671,245***
2008	51,072,988	44,709,133	415,237,161	17,178,639	20,761,858	—	***37,940,497***
2009	51,836,976	44,264,060	396,144,623	19,092,538	19,807,231	—	***38,899,770***
2010	52,524,376	43,825,641	375,077,795	21,066,828	18,753,890	—	***39,820,717***
2011	53,273,917	43,393,854	351,841,572	23,236,223	17,592,079	—	***40,828,302***
2012	54,023,848	42,968,673	326,282,655	25,558,916	16,314,133	—	***41,873,049***
2013	54,736,050	42,550,080	298,270,975	28,011,680	14,913,549	—	***42,925,229***
2014	55,430,701	42,138,055	267,653,233	30,617,742	13,382,662	—	***44,000,404***
2015	56,112,479	41,732,581	234,257,549	33,395,683	11,712,877	—	***45,108,561***
2016	56,904,115	41,333,642	197,791,265	36,466,284	9,889,563	—	***46,355,847***
2017	57,695,981	40,941,225	158,036,048	39,755,217	7,901,802	—	***47,657,020***
2018	55,579,941	38,558,004	117,463,242	40,572,805	5,873,162	—	***46,445,968***
2019	56,315,459	38,197,284	73,364,589	44,098,654	3,668,229	—	***47,766,883***
2020	57,033,124	37,842,739	25,512,463	47,852,126	1,275,623	—	***49,127,749***
2021	57,817,340	37,494,362	—	25,512,463	—	$28,435,140	***53,947,602***
2022	58,595,555	37,152,151	—	—	—	58,595,555	***58,595,555***
2023	59,408,119	36,816,104	—	—	—	59,408,119	***59,408,119***
2024	60,220,649	36,486,223	—	—	—	60,220,649	***60,220,649***
2025	61,104,748	36,162,510	—	—	—	61,104,748	***61,104,748***
2026	61,996,252	35,844,971	—	—	—	61,996,252	***61,996,252***
2027	62,907,446	35,533,612	—	—	—	62,907,446	***62,907,446***
Total	**$1,344,332,536**	**$995,822,209**		**$458,495,000**	**$273,457,179**	**$392,667,909**	***$1,124,620,087***

- By slowly drawing down the securitization proceeds, annual cash flow is 83.7% of adjusted payments and an average of 112.9% of rating agency worst case adjusted payments.

Case IV: Tax-Exempt Securitization Proceeds Invested at 8% and Expended Over the Life of the Bond Issue

Annual Cash Flow Analysis at 8% Earnings

Year	2003 WEFA Base Case	Rating Agency Worst Case Adjusted Payments	Securitization Proceeds	Outflow of Securitization Proceeds	Earnings at 8%	Residual	*ANNUAL CASH FLOW*
2003	$46,060,311	$45,272,024	$458,495,000	—	$36,679,600	—	***$36,679,600***
2004	40,040,632	38,734,711	453,389,720	$5,105,280	36,271,178	—	***41,376,457***
2005	40,562,250	38,342,033	447,443,626	5,946,095	35,795,490	—	***41,741,585***
2006	41,225,333	37,954,989	440,466,255	6,977,370	35,237,300	—	***42,214,671***
2007	41,853,944	37,573,550	432,415,800	8,050,455	34,593,264	—	***42,643,719***
2008	51,072,988	44,709,133	415,237,161	17,178,639	33,218,973	—	***50,397,612***
2009	51,836,976	44,264,060	396,144,623	19,092,538	31,691,570	—	***50,784,108***
2010	52,524,376	43,825,641	375,077,795	21,066,828	30,006,224	—	***51,073,051***
2011	53,273,917	43,393,854	351,841,572	23,236,223	28,147,326	—	***51,383,549***
2012	54,023,848	42,968,673	326,282,655	25,558,916	26,102,612	—	***51,661,529***
2013	54,736,050	42,550,080	298,270,975	28,011,680	23,861,678	—	***51,873,358***
2014	55,430,701	42,138,055	267,653,233	30,617,742	21,412,259	—	***52,030,001***
2015	56,112,479	41,732,581	234,257,549	33,395,683	18,740,604	—	***52,136,287***
2016	56,904,115	41,333,642	197,791,265	36,466,284	15,823,301	—	***52,289,585***
2017	57,695,981	40,941,225	158,036,048	39,755,217	12,642,884	—	***52,398,101***
2018	55,579,941	38,558,004	117,463,242	40,572,805	9,397,059	—	***49,969,865***
2019	56,315,459	38,197,284	73,364,589	44,098,654	5,869,167	—	***49,967,821***
2020	57,033,124	37,842,739	25,512,463	47,852,126	2,040,997	—	***49,893,123***
2021	57,817,340	37,494,362	—	25,512,463	—	$28,435,140	***53,947,602***
2022	58,595,555	37,152,151	—	—	—	58,595,555	***58,595,555***
2023	59,408,119	36,816,104	—	—	—	59,408,119	***59,408,119***
2024	60,220,649	36,486,223	—	—	—	60,220,649	***60,220,649***
2025	61,104,748	36,162,510	—	—	—	61,104,748	***61,104,748***
2026	61,996,252	35,844,971	—	—	—	61,996,252	***61,996,252***
2027	62,907,446	35,533,612	—	—	—	62,907,446	***62,907,446***
Total	**$1,344,332,536**	**$995,822,209**			**$437,531,486**	**$392,667,909**	***$1,288,694,395***

- By slowly drawing down the securitization proceeds, annual cash flow is 95.9% of adjusted payments and an average of 129% of rating agency worst case adjusted payments.

Case V: Tax-Exempt Securitization Proceeds Invested at 5% and Expended Rapidly to Provide Same Funds as Adjusted Payments

Annual Cash Flow Analysis at 5%

Year	2003 WEFA Base Case	Rating Agency Worst Case Adjusted Payments	Securitization Proceeds	Outflow of Securitization Proceeds	Earnings at 5%	Residual	*ANNUAL CASH FLOW*
2003	46,060,311	45,272,024	458,495,000	23,135,561	22,924,750	—	***46,060,311***
2004	40,040,632	38,734,711	435,359,439	18,272,660	21,767,972	—	***40,040,632***
2005	40,562,250	38,342,033	417,086,779	19,707,911	20,854,339	—	***40,562,250***
2006	41,225,333	37,954,989	397,378,867	21,356,390	19,868,943	—	***41,225,333***
2007	41,853,944	37,573,550	376,022,477	23,052,820	18,801,124	—	***41,853,944***
2008	51,072,988	44,709,133	352,969,657	33,424,505	17,648,483	—	***51,072,988***
2009	51,836,976	44,264,060	319,545,152	35,859,718	15,977,258	—	***51,836,976***
2010	52,524,376	43,825,641	283,685,434	38,340,105	14,184,272	—	***52,524,376***
2011	53,273,917	43,393,854	245,345,329	41,006,650	12,267,266	—	***53,273,917***
2012	54,023,848	42,968,673	204,338,678	43,806,914	10,216,934	—	***54,023,848***
2013	54,736,050	42,550,080	160,531,765	46,709,462	8,026,588	—	***54,736,050***
2014	55,430,701	42,138,055	113,822,303	49,739,586	5,691,115	—	***55,430,702***
2015	56,112,479	41,732,581	64,082,717	52,908,343	3,204,136	—	***56,112,479***
2016	56,904,115	41,333,642	11,174,373	11,174,373	558,719	—	***11,733,092***(a)
2017	57,695,981	40,941,225	—	—	—	—	—(a)
2018	55,579,941	38,558,004	—	—	—	—	—(a)
2019	56,315,459	38,197,284	—	—	—	—	—(a)
2020	57,033,124	37,842,739	—	—	—	—	—(a)
2021	57,817,340	37,494,362	—	—	—	28,435,140	***28,435,140***
2022	58,595,555	37,152,151	—	—	—	58,595,555	***58,595,555***
2023	59,408,119	36,816,104	—	—	—	59,408,119	***59,408,119***
2024	60,220,649	36,486,223	—	—	—	60,220,649	***60,220,649***
2025	61,104,748	36,162,510	—	—	—	61,104,748	***61,104,748***
2026	61,996,252	35,844,971	—	—	—	61,996,252	***61,996,252***
2027	62,907,446	35,533,612	—	—	—	62,907,446	***62,907,446***
Total	**$1,344,332,536**			**$458,495,000**	**$191,991,898**	**$392,667,909**	***$1,043,154,807***

(a) The State would not have any money for these years. The State may reserve required amounts over the life of the bond issue, resecuritization future bond issue or secure a one-time appropriation.

Securitization proceeds expended rapidly will enable the State to realize annual cash flow equal to the adjusted payments for 13 years with investment rate of 5%.

Case VI: Tax-Exempt Securitization Proceeds Invested at 8% and Expended Rapidly to Provide Same Funds as Adjusted Payments

Annual Cash Flow Analysis at 8%

Year	2003 WEFA Base Case	Rating Agency Worst Case Adjusted Payments	Securitization Proceeds	Outflow of Securitization Proceeds	Earnings at 8%	Residual	*ANNUAL CASH FLOW*
2003	$46,060,311	$45,272,024	$458,495,000	$9,380,711	$36,679,600	—	***$46,060,311***
2004	40,040,632	38,734,711	449,114,289	4,111,489	35,929,143	—	***40,040,632***
2005	40,562,250	38,342,033	445,002,800	4,962,026	35,600,224	—	***40,562,250***
2006	41,225,333	37,954,989	440,040,773	6,022,071	35,203,262	—	***41,225,333***
2007	41,853,944	37,573,550	434,018,702	7,132,448	34,721,496	—	***41,853,944***
2008	51,072,988	44,709,133	426,886,254	16,922,088	34,150,900	—	***51,072,988***
2009	51,836,976	44,264,060	409,964,166	19,039,843	32,797,133	—	***51,836,976***
2010	52,524,376	43,825,641	390,924,324	21,250,431	31,273,946	—	***52,524,376***
2011	53,273,917	43,393,854	369,673,893	23,700,005	29,573,911	—	***53,273,917***
2012	54,023,848	42,968,673	345,973,888	26,345,937	27,677,911	—	***54,023,848***
2013	54,736,050	42,550,080	319,627,951	29,165,814	25,570,236	—	***54,736,050***
2014	55,430,701	42,138,055	290,462,137	32,193,731	23,236,971	—	***55,430,701***
2015	56,112,479	41,732,581	258,268,407	35,451,007	20,661,473	—	***56,112,479***
2016	56,904,115	41,333,642	222,817,400	39,078,723	17,825,392	—	***56,904,115***
2017	57,695,981	40,941,225	183,738,678	42,996,887	14,699,094	—	***57,695,981***
2018	55,579,941	38,558,004	140,741,790	44,320,598	11,259,343	—	***55,579,941***
2019	56,315,459	38,197,284	96,421,192	48,601,764	7,713,695	—	***56,315,459***
2020	57,033,124	37,842,739	47,819,428	47,819,428	3,825,554	—	***51,644,983***[a]
2021	57,817,340	37,494,362	—	—	—	$28,435,140	***28,435,140***
2022	58,595,555	37,152,151	—	—	—	58,595,555	***58,595,555***
2023	59,408,119	36,816,104	—	—	—	59,408,119	***59,408,119***
2024	60,220,649	36,486,223	—	—	—	60,220,649	***60,220,649***
2025	61,104,748	36,162,510	—	—	—	61,104,748	***61,104,748***
2026	61,996,252	35,844,971	—	—	—	61,996,252	***61,996,252***
2027	62,907,446	35,533,612	—	—	—	62,907,446	***62,907,446***
Total	**$1,344,332,536**	**$995,822,209**			**$458,399,286**	**$392,667,909**	***$1,309,562,195***

(a) The State would not have as much in revenues as projected for these years. The State may reserve required amounts over the life of the bond issue, resecuritization future bond issue or secure a one-time appropriation.

Securitization proceeds expended rapidly will enable the State to realize annual cash flow equal to the adjusted payments for nearly every year with investment rate of 8%.

Case I: Taxable Securitization Proceeds Invested at 5% (Fixed Income)

Annual Cash Flow Analysis at 5% Earnings

Year	2003 WEFA Base Case	Rating Agency Worst Case Adjusted Payments	Securitization Proceeds	Earnings at 5%	Residual	*ANNUAL CASH FLOW*
2003	$46,060,311	$45,272,024	$368,665,000	$18,433,250	—	***$18,433,250***
2004	40,040,632	38,734,711	—	18,433,250	—	***18,433,250***
2005	40,562,250	38,342,033	—	18,433,250	—	***18,433,250***
2006	41,225,333	37,954,989	—	18,433,250	—	***18,433,250***
2007	41,853,944	37,573,550	—	18,433,250	—	***18,433,250***
2008	51,072,988	44,709,133	—	18,433,250	—	***18,433,250***
2009	51,836,976	44,264,060	—	18,433,250	—	***18,433,250***
2010	52,524,376	43,825,641	—	18,433,250	—	***18,433,250***
2011	53,273,917	43,393,854	—	18,433,250	—	***18,433,250***
2012	54,023,848	42,968,673	—	18,433,250	—	***18,433,250***
2013	54,736,050	42,550,080	—	18,433,250	—	***18,433,250***
2014	55,430,701	42,138,055	—	18,433,250	—	***18,433,250***
2015	56,112,479	41,732,581	—	18,433,250	—	***18,433,250***
2016	56,904,115	41,333,642	—	18,433,250	—	***18,433,250***
2017	57,695,981	40,941,225	—	18,433,250	—	***18,433,250***
2018	55,579,941	38,558,004	—	18,433,250	—	***18,433,250***
2019	56,315,459	38,197,284	—	18,433,250	$7,696,009	***26,129,259***
2020	57,033,124	37,842,739	—	18,433,250	57,033,124	***75,466,374***
2021	57,817,340	37,494,362	—	18,433,250	57,817,340	***76,250,590***
2022	58,595,555	37,152,151	—	18,433,250	58,595,555	***77,028,805***
2023	59,408,119	36,816,104	—	18,433,250	59,408,119	***77,841,369***
2024	60,220,649	36,486,223	—	18,433,250	60,220,649	***78,653,899***
2025	61,104,748	36,162,510	—	18,433,250	61,104,748	***79,537,998***
2026	61,996,252	35,844,971	—	18,433,250	61,996,252	***80,429,502***
2027	62,907,446	35,533,612	—	18,433,250	62,907,446	***450,005,696***
Total	**$1,344,332,536**	**$995,822,209**	**$368,665,000**	**$460,831,250**	**$422,050,109**	***$1,316,275,492***

- The securitization proceeds are invested and remain available after the bonds are paid off.

Case II: Taxable Securitization Proceeds Invested at 8% (Fixed Income and Equities)

Annual Cash Flow Analysis at 8% Earnings

Year	2003 WEFA Base Case	Rating Agency Worst Case Adjusted Payments	Securitization Proceeds	Earnings at 8%	Residual	*ANNUAL CASH FLOW*
2003	$46,060,311	$45,272,024	$368,665,000	$29,493,200	—	***$29,493,200***
2004	40,040,632	38,734,711	—	29,493,200	—	***29,493,200***
2005	40,562,250	38,342,033	—	29,493,200	—	***29,493,200***
2006	41,225,333	37,954,989	—	29,493,200	—	***29,493,200***
2007	41,853,944	37,573,550	—	29,493,200	—	***29,493,200***
2008	51,072,988	44,709,133	—	29,493,200	—	***29,493,200***
2009	51,836,976	44,264,060	—	29,493,200	—	***29,493,200***
2010	52,524,376	43,825,641	—	29,493,200	—	***29,493,200***
2011	53,273,917	43,393,854	—	29,493,200	—	***29,493,200***
2012	54,023,848	42,968,673	—	29,493,200	—	***29,493,200***
2013	54,736,050	42,550,080	—	29,493,200	—	***29,493,200***
2014	55,430,701	42,138,055	—	29,493,200	—	***29,493,200***
2015	56,112,479	41,732,581	—	29,493,200	—	***29,493,200***
2016	56,904,115	41,333,642	—	29,493,200	—	***29,493,200***
2017	57,695,981	40,941,225	—	29,493,200	—	***29,493,200***
2018	55,579,941	38,558,004	—	29,493,200	—	***29,493,200***
2019	56,315,459	38,197,284	—	29,493,200	$7,696,009	***37,189,209***
2020	57,033,124	37,842,739	—	29,493,200	57,033,124	***86,526,324***
2021	57,817,340	37,494,362	—	29,493,200	57,817,340	***87,310,540***
2022	58,595,555	37,152,151	—	29,493,200	58,595,555	***88,088,755***
2023	59,408,119	36,816,104	—	29,493,200	59,408,119	***88,901,319***
2024	60,220,649	36,486,223	—	29,493,200	60,220,649	***89,713,849***
2025	61,104,748	36,162,510	—	29,493,200	61,104,748	***90,597,948***
2026	61,996,252	35,844,971	—	29,493,200	61,996,252	***91,489,452***
2027	62,907,446	35,533,612	—	29,493,200	62,907,446	***461,065,646***
Total	**$1,344,332,536**	**$995,822,209**	**$368,665,000**	**$737,330,000**	**$422,050,109**	***$1,592,774,242***

- Securitization proceeds invested at 8% will produce $1.593 billion over 25 years vs. a range of $996 million to $1.344 billion without securitization.

Case III: Taxable Securitization Proceeds Invested at 5% and Expended Over the Life of the Bond Issue

Annual Cash Flow Analysis at 5% Earnings

Year	2003 WEFA Base Case	Rating Agency Worst Case Adjusted Payments	Securitization Proceeds	Outflow of Securitization Proceeds	Earnings at 5%	Residual	*ANNUAL CASH FLOW*
2003	$46,060,311	$45,272,024	$368,665,000		$18,433,250	—	***$18,433,250***
2004	40,040,632	38,734,711	365,367,044	3,297,956	18,268,352	—	***21,566,308***
2005	40,562,250	38,342,033	361,299,262	4,067,783	18,064,963	—	***22,132,746***
2006	41,225,333	37,954,989	356,261,224	5,038,038	17,813,061	—	***22,851,099***
2007	41,853,944	37,573,550	350,198,269	6,062,955	17,509,913	—	***23,572,868***
2008	51,072,988	44,709,133	335,188,926	15,009,343	16,759,446	—	***31,768,790***
2009	51,836,976	44,264,060	318,134,304	17,054,622	15,906,715	—	***32,961,338***
2010	52,524,376	43,825,641	298,915,967	19,218,337	14,945,798	—	***34,164,135***
2011	53,273,917	43,393,854	277,287,936	21,628,031	13,864,397	—	***35,492,428***
2012	54,023,848	42,968,673	253,027,007	24,260,929	12,651,350	—	***36,912,280***
2013	54,736,050	42,550,080	225,937,306	27,089,701	11,296,865	—	***38,386,566***
2014	55,430,701	42,138,055	195,772,854	30,164,452	9,788,643	—	***39,953,095***
2015	56,112,479	41,732,581	162,274,004	33,498,850	8,113,700	—	***41,612,550***
2016	56,904,115	41,333,642	125,039,900	37,234,104	6,251,995	—	***43,486,099***
2017	57,695,981	40,941,225	83,733,459	41,306,441	4,186,673	—	***45,493,114***
2018	55,579,941	38,558,004	40,636,829	43,096,630	2,031,841	—	***45,128,472***
2019	56,315,459	38,197,284	—	40,636,829	—	$7,696,009	***48,332,838***
2020	57,033,124	37,842,739	—	—	—	57,033,124	***57,033,124***
2021	57,817,340	37,494,362	—	—	—	57,817,340	***57,817,340***
2022	58,595,555	37,152,151	—	—	—	58,595,555	***58,595,555***
2023	59,408,119	36,816,104	—	—	—	59,408,119	***59,408,119***
2024	60,220,649	36,486,223	—	—	—	60,220,649	***60,220,649***
2025	61,104,748	36,162,510	—	—	—	61,104,748	***61,104,748***
2026	61,996,252	35,844,971	—	—	—	61,996,252	***61,996,252***
2027	62,907,446	35,533,612	—	—	—	62,907,446	***62,907,446***
Total	**$1,344,332,536**	**$995,822,209**			**$205,886,965**	**$422,050,109**	***$1,061,331,207***

- By slowly drawing down the securitization proceeds, annual cash flow is 78.9% of adjusted payments and an average of 106.6% of rating agency worst case adjusted payments.

Case IV: Taxable Securitization Proceeds Invested at 8% and Expended Over the Life of the Bond Issue

Annual Cash Flow Analysis at 8% Earnings

Year	2003 WEFA Base Case	Rating Agency Worst Case Adjusted Payments	Securitization Proceeds	Outflow of Securitization Proceeds	Earnings at 8%	Residual	*ANNUAL CASH FLOW*
2003	$46,060,311	$45,272,024	$368,665,000	—	$29,493,200	—	***$29,493,200***
2004	40,040,632	38,734,711	365,367,044	3,297,956	29,229,364	—	***32,527,319***
2005	40,562,250	38,342,033	361,299,262	4,067,783	28,903,941	—	***32,971,723***
2006	41,225,333	37,954,989	356,261,224	5,038,038	28,500,898	—	***33,538,935***
2007	41,853,944	37,573,550	350,198,269	6,062,955	28,015,862	—	***34,078,816***
2008	51,072,988	44,709,133	335,188,926	15,009,343	26,815,114	—	***41,824,457***
2009	51,836,976	44,264,060	318,134,304	17,054,622	25,450,744	—	***42,505,367***
2010	52,524,376	43,825,641	298,915,967	19,218,337	23,913,277	—	***43,131,614***
2011	53,273,917	43,393,854	277,287,936	21,628,031	22,183,035	—	***43,811,066***
2012	54,023,848	42,968,673	253,027,007	24,260,929	20,242,161	—	***44,503,090***
2013	54,736,050	42,550,080	225,937,306	27,089,701	18,074,984	—	***45,164,685***
2014	55,430,701	42,138,055	195,772,854	30,164,452	15,661,828	—	***45,826,281***
2015	56,112,479	41,732,581	162,274,004	33,498,850	12,981,920	—	***46,480,770***
2016	56,904,115	41,333,642	125,039,900	37,234,104	10,003,192	—	***47,237,296***
2017	57,695,981	40,941,225	83,733,459	41,306,441	6,698,677	—	***48,005,118***
2018	55,579,941	38,558,004	40,636,829	43,096,630	3,250,946	—	***46,347,576***
2019	56,315,459	38,197,284	—	40,636,829	—	$7,696,009	***48,332,838***
2020	57,033,124	37,842,739	—	—	—	57,033,124	***57,033,124***
2021	57,817,340	37,494,362	—	—	—	57,817,340	***57,817,340***
2022	58,595,555	37,152,151	—	—	—	58,595,555	***58,595,555***
2023	59,408,119	36,816,104	—	—	—	59,408,119	***59,408,119***
2024	60,220,649	36,486,223	—	—	—	60,220,649	***60,220,649***
2025	61,104,748	36,162,510	—	—	—	61,104,748	***61,104,748***
2026	61,996,252	35,844,971	—	—	—	61,996,252	***61,996,252***
2027	62,907,446	35,533,612	—	—	—	62,907,446	***62,907,446***
Total	**$1,344,332,536**	**$995,822,209**			**$329,419,143**	**$422,050,109**	***$1,184,863,385***

- By slowly drawing down the securitization proceeds, annual cash flow is 88.1% of adjusted payments and an average of 119% of rating agency worst case adjusted payments.

Case V: Taxable Securitization Proceeds Invested at 5% and Expended Rapidly to Provide Same Funds as Adjusted Payments

Annual Cash Flow Analysis at 5%

Year	2003 WEFA Base Case	Rating Agency Worst Case Adjusted Payments	Securitization Proceeds	Outflow of Securitization Proceeds	Earnings at 5%	Residual	*ANNUAL CASH FLOW*
2003	$46,060,311	$45,272,024	$368,665,000	$27,627,061	$18,433,250	—	***$46,060,311***
2004	40,040,632	38,734,711	341,037,939	22,988,735	17,051,897	—	***40,040,632***
2005	40,562,250	38,342,033	318,049,204	24,659,790	15,902,460	—	***40,562,250***
2006	41,225,333	37,954,989	293,389,413	26,555,862	14,669,471	—	***41,225,333***
2007	41,853,944	37,573,550	266,833,551	28,512,267	13,341,678	—	***41,853,944***
2008	51,072,988	44,709,133	238,321,284	39,156,924	11,916,064	—	***51,072,988***
2009	51,836,976	44,264,060	199,164,360	41,878,758	9,958,218	—	***51,836,976***
2010	52,524,376	43,825,641	157,285,603	44,660,096	7,864,280	—	***52,524,376***
2011	53,273,917	43,393,854	112,625,506	47,642,641	5,631,275	—	***53,273,917***
2012	54,023,848	42,968,673	64,982,865	50,774,704	3,249,143	—	***54,023,848***
2013	54,736,050	42,550,080	14,208,160	14,208,160	710,408	—	***14,918,568***
2014	55,430,701	42,138,055	—	—	—	—	—(a)
2015	56,112,479	41,732,581	—	—	—	—	—(a)
2016	56,904,115	41,333,642	—	—	—	—	—(a)
2017	57,695,981	40,941,225	—	—	—	—	—(a)
2018	55,579,941	38,558,004	—	—	—	—	—(a)
2019	56,315,459	38,197,284	—	—	—	$7,696,009	***7,696,009***
2020	57,033,124	37,842,739	—	—	—	57,033,124	***57,033,124***
2021	57,817,340	37,494,362	—	—	—	57,817,340	***57,817,340***
2022	58,595,555	37,152,151	—	—	—	58,595,555	***58,595,555***
2023	59,408,119	36,816,104	—	—	—	59,408,119	***59,408,119***
2024	60,220,649	36,486,223	—	—	—	60,220,649	***60,220,649***
2025	61,104,748	36,162,510	—	—	—	61,104,748	***61,104,748***
2026	61,996,252	35,844,971	—	—	—	61,996,252	***61,996,252***
2027	62,907,446	35,533,612	—	—	—	62,907,446	***62,907,446***
Total	**$1,344,332,536**	**$995,822,209**			**$118,728,144**	**$422,050,109**	***$974,172,386***

(a) The State would not have any money for these years. The State may reserve required amounts over the life of the bond issue, resecuritization future bond issue or secure a one-time appropriation.

Securitization proceeds expended rapidly will enable the State to realize annual cash flow equal to the adjusted payments for 10 years with investment rate of 5%.

Case VI: Taxable Securitization Proceeds Invested at 8% and Expended Rapidly to Provide Same Funds as Adjusted Payments

Annual Cash Flow Analysis at 8%

Year	2003 WEFA Base Case	Rating Agency Worst Case Adjusted Payments	Securitization Proceeds	Outflow of Securitization Proceeds	Earnings at 8%	Residual	*ANNUAL CASH FLOW*
2003	$46,060,311	$45,272,024	$368,665,000	$16,567,111	$29,493,200	—	***$46,060,311***
2004	40,040,632	38,734,711	352,097,889	11,872,801	28,167,831	—	***40,040,632***
2005	40,562,250	38,342,033	340,225,088	13,344,243	27,218,007	—	***40,562,250***
2006	41,225,333	37,954,989	326,880,844	15,074,865	26,150,468	—	***41,225,333***
2007	41,853,944	37,573,550	311,805,979	16,909,466	24,944,478	—	***41,853,944***
2008	51,072,988	44,709,133	294,896,513	27,481,267	23,591,721	—	***51,072,988***
2009	51,836,976	44,264,060	267,415,246	30,443,756	21,393,220	—	***51,836,976***
2010	52,524,376	43,825,641	236,971,490	33,566,657	18,957,719	—	***52,524,376***
2011	53,273,917	43,393,854	203,404,832	37,001,530	16,272,387	—	***53,273,917***
2012	54,023,848	42,968,673	166,403,302	40,711,584	13,312,264	—	***54,023,848***
2013	54,736,050	42,550,080	125,691,719	44,680,712	10,055,337	—	***54,736,050***
2014	55,430,701	42,138,055	81,011,006	48,949,821	6,480,880	—	***55,430,701***
2015	56,112,479	41,732,581	32,061,185	32,061,185	2,564,895	—	***34,626,080***[a]
2016	56,904,115	41,333,642	—	—	—	—	—[a]
2017	57,695,981	40,941,225	—	—	—	—	—[a]
2018	55,579,941	38,558,004	—	—	—	—	—[a]
2019	56,315,459	38,197,284	—	—	—	$7,696,009	***7,696,009***
2020	57,033,124	37,842,739	—	—	—	57,033,124	***57,033,124***
2021	57,817,340	37,494,362	—	—	—	57,817,340	***57,817,340***
2022	58,595,555	37,152,151	—	—	—	58,595,555	***58,595,555***
2023	59,408,119	36,816,104	—	—	—	59,408,119	***59,408,119***
2024	60,220,649	36,486,223	—	—	—	60,220,649	***60,220,649***
2025	61,104,748	36,162,510	—	—	—	61,104,748	***61,104,748***
2026	61,996,252	35,844,971	—	—	—	61,996,252	***61,996,252***
2027	62,907,446	35,533,612	—	—	—	62,907,446	***62,907,446***
Total	**$1,344,332,536**	**$995,822,209**			**$248,602,407**	**$422,050,109**	***$1,104,046,649***

(a) The State would not have any money for these years. The State may reserve required amounts over the life of the bond issue, resecuritization future bond issue or secure a one-time appropriation.

Securitization proceeds expended rapidly will enable the State to realize annual cash flow equal to the adjusted payments for 12 years with investment rate of 8%.

A securitization scenario under Case IV or Case VI is the State Treasurer’s recommendation.

- For both taxable and tax-exempt financings, Case IV achieves higher cash flows over the 25-year period.

- Case VI matches the adjusted payments cash flows in all years except 2020, assuming a tax-exempt financing. For a taxable financing, Case VI matches the adjusted payments cash flows except from 2015 to 2018, when additional State funding might be required or a re-securitization may be necessary.

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Attorney General

THOMAS M. PATTON
First Assistant Attorney General

December 11, 2000

Governor Kenny Guinn
State Capitol Building
Carson City, NV 89701

RE: Tobacco Master Settlement Receipts

Dear Governor Guinn:

On November 28, 2000, I attended a meeting of the National Association of Attorneys General regarding the settlement entered into by 46 states as well as other jurisdictions with the major tobacco manufacturers. The topics of the meeting included the reliability of receipts under the Master Settlement Agreement ("MSA") as well as implementation of the MSA and reducing sales of tobacco to minors on the Internet.

There are numerous reasons why the actual amount received by the State of Nevada may be less than what was originally projected in the MSA. These have been summarized in earlier correspondence and is available on the Attorney General's website at:

http://ag.state.nv.us/tobacco/tobsumm.pdf.

The primary point is that although the funds are projected to be received by the State of Nevada, they may not actually be received.

I am taking all steps that I can to maximize the amount of funds that will be received by Nevada. For example, my office is one of only two states that have filed civil actions against non-participating manufacturers ("NPMs") to enforce NRS Chapter 370A. The MSA requires states to "diligently" enforce this statute and States that do not are subject to a downward adjustment in settlement payments. NPM's are tobacco manufacturers that have declined to sign the MSA. They are required to establish an escrow account and deposit about 1 cent per cigarette sold in Nevada into that account. Currently, my office has filed three civil actions against NPMs that have violated NRS Chapter 370A. We will continue to file additional actions to assure that participating manufacturers do not reduce settlement payments because this statute is not being diligently enforced.

In addition, my office continues to monitor compliance with the advertising restrictions of the MSA. For example, we have distributed a brochure describing the advertising restrictions of the MSA and encouraging citizens to report possible violations. Nevada has joined with other states in negotiating the meaning of advertising limitations imposed by the MSA. For example, I have signed a letter from numerous state Attorneys General to one participating manufacturer to require that the manufacturer stop the distribution of free matchbooks that advertise cigarettes. Further, this office is inspecting locations where cigarettes and tobacco products are given away as free samples to assure that no one under 18 is given any tobacco products.

If you or your staff have questions regarding the amounts to be received under the MSA, please contact John Albrecht, Senior Deputy Attorney General, at 775-688-1872. I look forward to continue working with you to assure that Nevada receives the maximum possible under the MSA.

Finally, please be aware that in addition to the major on-going efforts put forth by this office, the National Association of Attorneys General is expending substantial time and monetary resources relative to this issue. In that regard, efforts to keep the National Governor's Association appraised are also in place.

Cordially,

Frankie Sue Del Papa
Attorney General

Cc: Perry Commeaux
Brian Krolicki
Charlotte Crawford
Barbara Buckley
Vivian Freeman
Ray Rawson
John Albrecht

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THOMAS M. PATTON
First Assistant Attorney General

August 4, 2000

Honorable Kenny Guinn, Governor
State of Nevada
Capitol Complex
Carson City, Nevada 89710

Dear Governor Guinn:

On June 30, 2000, this office provided you with a letter advising of the very strong possibility that one or more major tobacco companies could be forced into or elect to file for bankruptcy. This issue was discussed in some detail at the summer meeting of the National Association of Attorneys General and continues to grow in significance due to the ever-increasing number of lawsuits filed against the tobacco industry.

At the current time, the tobacco industry faces a $146 billion punitive damages judgment awarded to plaintiffs in a Florida class action lawsuit decided July 14, 2000, as well as an action brought by the U.S. Department of Justice on behalf of the federal government and numerous other pending or threatened individual and class actions throughout the country. Although it is our opinion that the punitive damages awarded in the Florida class action are likely to be reduced by the trial or appellate courts based upon existing Florida law, the final outcome and financial impact to the tobacco industry as a result of that action is far from certain. Moreover, the law concerning punitive damages varies among the states and thus there exists a strong potential for divergent outcomes in such cases. As in the past, we will continue to keep you updated concerning the existence, progress and outcome of such litigation as it continues to unfold both at the trial and appellate levels.

On August 3, 2000, First Assistant Attorney Thomas M. Patton traveled to Chicago and attended an in-depth legal briefing arranged by the National Association of Attorneys General on the issue of possible chapter 7 liquidation or chapter 11 reorganization bankruptcy filings by one or more major tobacco companies. Through NAAG and its tobacco bankruptcy committee headed by Attorneys General Bill Sorrell of Vermont, Janet Napolitano of Arizona, and Paul Summers of Tennessee, the state attorneys general have retained a nationally prominent bankruptcy firm and are taking a prudent and proactive lead role in preparing for the possibility of tobacco industry bankruptcy filings. Every effort is being made to prepare for such potential action and to preserve the states' ability to receive all damages agreed upon under the Master

Settlement Agreement reached with the four original participating manufacturers. Suffice it to say, however, that a bankruptcy filing by one or more of the major tobacco companies would dwarf any bankruptcy action ever initiated in this country. Given the enormity and complexity of such a potential action or actions, the thousands of creditors that exist, and the continuing liability that confronts the tobacco industry, it is expected that resolution of any such bankruptcy case would involve an extremely lengthy, difficult and uncertain process.

Although we are unable at this time to estimate the likelihood of a bankruptcy filing by one or more of the tobacco companies, we wish to once again make clear that a very real possibility of such an action or actions exists. In addition, in the event one or more bankruptcy actions were initiated, the position of the settling states in relation to other tobacco industry creditors is uncertain and will depend upon how federal bankruptcy and appellate courts, possibly in more than one jurisdiction, decide a number of complex legal issues. As a result, it must once again be stressed that the flow of income owed to the states as a result of the master settlement agreement remains subject to both change and to possible discontinuation at least during the time period that one or more potential bankruptcy actions remain unresolved. We therefore once again urge the Governor and the Legislature to be cautious concerning any commitment or expenditure of tobacco settlement proceeds not yet received by Nevada, and to exercise the utmost in fiscal restraint in light of these concerns.

Cordially,

Frankie Sue Del Papa

FRANKIE SUE DEL PAPA
Attorney General

FSDP:mas

Cc: Lorraine Hunt, Lt. Governor
Dean Heller, Secretary of State
Brian Krolicki, State Treasurer
Kathy Augustine, State Controller
Nevada Legislature
Task Force for the Fund for a Healthy Nevada
Board of Trustees for Trust Fund for Public Health
Board of Regents, Nevada University and Community College System
J. Perry Comeaux, Director, Dept. of Administration
Legislative Counsel Bureau

State tobacco bond issuance

Sale Date	Issuer	Amount ($MM)
May-99	SB 496 fails to pass in the Legislature after passing in the Senate Finance (Amend. No. 1100)	
Oct-00	Alaska	$116.05
Oct-00	Puerto Rico	397.01
Jun-01	SB 488 fails to pass in the Nevada Assembly after passing in the Nevada Senate	
Mar-02	South Carolina	934.53
Aug-02	Alaska	126.79
Oct-02	Iowa	644.26
Nov-02	Louisiana	1,202.77
May-02	Wisconsin	1,591.10
Jun-02	Rhode Island	685.43
Aug-02	New Jersey	1,801.46
Aug-02	South Dakota	278.05
Oct-02	Puerto Rico	1,171.20
Oct-02	Washington	517.91
Jan-03	California	2,625.00
Total:		**$12,091.56**[a]

[a] Including local government, almost $16 billion of tobacco-backed bond issues have come to market to date.

Barron's Online
Monday, January 13, 2003

Marlboro Munis

Tobacco bonds offer high yields -- but with special risks

By ANDREW BARY

LIKE LOTTERY WINNERS who want their prizes now rather than meted out over decades, cash-hungry state and local governments have been borrowing against their shares of the 1998 multibillion settlement of their suits against the major tobacco companies. With some $13 billion already issued, California this week will make the biggest offering yet of "tobacco bonds" -- a massive $3 billion worth. While these securities have been popular with bond buyers owing to their high tax-free yields, some conservative investors have been wary of the sector.

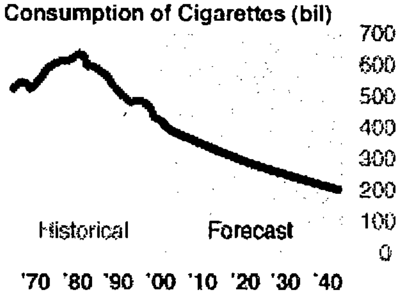
California and other states are selling tobacco bonds to help plug growing budget deficits -- the Golden State's gap has been projected at an enormous $35 billion over the next 18 months. This may be a dubious financial strategy because states are sacrificing decades' worth of revenues for one-time gains. But monetizing future tobacco-settlement revenues is painless politically because it doesn't involve raising taxes or cutting spending.

California is expected to follow up this week's sale with a $1.5 billion deal in the spring. New York Gov. George Pataki has proposed selling $4 billion of tobacco bonds to help close the state's projected budget gap in its fiscal year starting in April. Other states, including Missouri and Indiana, also are considering tobacco-bond deals. If the states pledged all their payments from the tobacco settlement, the total tobacco bond market could hit $75 billion, according to a UBS/PaineWebber analysis.

For investors, the allure of tax-free tobacco bonds is their high yields. The two largest parts of the California deal, $1.26 billion of bonds due in 2033 and $1.3 billion of bonds maturing in 2041, are expected to yield above 6%. The talk on Wall Street Friday was that the shorter-maturity bond would yield about 61/8% and the longer maturity, 6½% or more. The tobacco bonds of other states have similar yields. This compares with the current 5% yield on top-rated, long-term municipal bonds. A 6% yield on a California tax-free bond for a California resident in a high tax bracket is equivalent to a taxable bond yielding 10%.

DYING HABIT

Since its peak in 1981, U.S. cigarette consumption has declined steadily and is forecast to fall 50% over the next 40 years. Last year, Americans smoked an estimated 403 billion cigarettes.



Source: Global Insight

While most tobacco bonds have been sold to institutions, primarily yield-oriented bond funds, the California deal will also target individuals. The bonds will be sold in $5,000 denominations and aren't subject to the alternative minimum tax.

A key benefit of the tobacco bonds is high credit ratings. The California deal has received a rating of single-A1 from Moody's Investor's Service and a slightly lower rating of single-A from Standard & Poor's, the other major bond rater.

"These bonds are very attractive given the combination of yield and rating. There's nothing like them in the municipal market," says Ron Fielding, a senior vice president at Oppenheimer who oversees its municipal-bond funds.

Although tobacco bonds have high ratings (see table below), they are risky because California and other states are pledging only their payments from the 1998 settlement as security for the bonds. To help distinguish tobacco debt from their regular debt, the states have established separate entities that typically don't contain the states' names. The California issuer, for instance, is Golden State Tobacco Securitization Corp.

The tobacco debt has been controversial in the $275 billion muni-fund industry. Some companies, like giant Vanguard with $63 billion in municipal- fund assets, have shunned most tobacco debt. Oppenheimer has been among the most enthusiastic buyers with about $1 billion of its $12 billion in assets allocated to tobacco bonds. T. Rowe Price has a 1% exposure on average in its muni funds and the Smith Barney muni funds have a 3% allocation. Most fund companies have a cap of 5% of assets on their exposure to the sector, although Oppenheimer has higher limits.

"We're cautious," says Mary Miller, a portfolio manager at T. Rowe Price. "You're making a judgment on future smoking levels and the health of the companies that made the settlement with the states. The market appreciates that these are risky bonds." One concern: many funds could bump up against limits on their tobacco holdings.

Bond repayment hinges on the health of the U.S. tobacco industry and, in particular, the four major cigarette companies that control about 90% of the market: **Philip Morris**; **R.J. Reynolds**; **Loews'** Lorillard division, and Brown and Williamson, a division of **British American Tobacco**. Philip Morris, Loews and BAT have single-A credit ratings while Reynolds is rated lower at Baa2.

Table: Growing Market[1]

The bankruptcy of any of the major cigarette companies stemming from litigation or other factors would threaten the tobacco bonds, but the settlement was structured so that the cigarette makers have incentives to keep making payments even in bankruptcy.

The 1998 settlement with 46 states and Puerto Rico (the other four states settled separately) ended the threat from the states against the industry to recover the cost of treating ill smokers. The payments total $206 billion over the first 25 years and then continue into perpetuity. The base payment is $6.5 billion in 2003, rising to $8 billion annually in 2004 through 2007; $8.14 billion a year in 2009 through 2017 and then $9 billion annually thereafter. California and New York get the biggest share at 12.8% each, meaning California will be entitled to about $1 billion annually starting in 2004.

California and New York are splitting the proceeds with cities and other localities. It was initially assumed that the states would earmark the settlement money for the cost of caring for poor people with smoking-related illnesses and pay for programs to combat youth smoking. But budget problems have prompted numerous states to monetize all or part of their payments. California is pledging 54% of its revenues over the next 40 years as collateral for this week's bond issue.

It's important to understand that the tobacco companies aren't guaranteeing fixed annual payments to the states under the settlement agreement. The payments are based on U.S. cigarette volume, which has declined steadily over the past two decades since peaking at 640 billion cigarettes in 1981 (32 billion packs) to an estimated 403 billion in 2002.

Per-capita consumption has fallen even more sharply since 1981. The roughly 200 million Americans aged 18 and over smoked an average of about 100 packs each last year, down from over 200 packs in 1965. About 23% of adults now smoke, down from 42% in 1965.

An economic-consulting firm, Global Insight, prepared cigarette-consumption forecasts for the California deal and other tobacco bonds. It assumes that consumption will decline 1.7% annually over the next 40 years, resulting in a cumulative decline of 50% over that span.

There's obvious risk to that forecast. The sharp increase in many state excise taxes in the past year has pushed the average price of a pack of premium cigarettes to about $4 nationally and $7.50 in high-tax locales like New York City, crimping consumption and hurting industry profits.

The rating agencies are well aware of these risks and factor them into their ratings. Moody's, for instance, assumes that tobacco deals can still repay investors in full if tobacco consumption declines at a 3.5% annual rate. Consumption fell an estimated 3.7% in 2002 after dropping 2.6% in 2001. In the California deal, projected settlement payments are equal to about 1.6 times annual debt-service costs.

A key offset to declining cigarette volume is an inflation component, which increases at least 3% each year. Oppenheimer's Fielding says this aspect of the settlement agreement gives the bonds some inherent protection from inflation because significant price hikes will boost the annual payments to the states.

One of the advantages of the California deal is that the two largest parts, the bonds due in 2033 and 2041, have a feature that is designed to result in shorter maturities. The 2033 bond is expected to have an average life of 8.4 years and mature in 2015. The 2041 maturity is expected to have an average life of 16 years.

Tobacco bonds could be a reasonable bet for muni buyers willing to accept the risks in exchange for high yields.

Wednesday's Market

Municipal Bonds Firm With Treasuries; $2.6B California Tobacco Sale Hits 7%

By Sean Monsarrat and Nicholas Chesla
The Bond Buyer Wire

Municipal bonds firmed in sympathy with Treasury market gains yesterday, although the secondary market was overshadowed by a much-anticipated $2.6 billion **California** tobacco loan that featured a top yield of 7%.

Governments rose after investors bought bonds as stocks fell and North Korea reportedly rejected a U.S. offer to discuss nuclear arms, while economic news appeared to have little effect on bonds.

The Empire State manufacturing index rose 8.4 points to 20.7. The producer price index was unchanged in December and fell 0.3%, excluding volatile food and energy prices. Business inventories rose 0.2% in November while sales rose 0.3%.

Mike Moran, chief economist at **Daiwa Securities**, said the December PPI indicated inflation in prices paid to producers for their output was nonexistent, as was deflation, while the modest rise in business inventories showed businesses were managing stockpiles cautiously.

"We have lean inventories in general at a time the economy is growing, but we are not seeing businesses willing to add to them," he said. "I would say the inventory situation is well balanced, especially in the early stages of the production and distribution process."

In the municipal arena, the California tobacco deal loomed large over the rest of the market and featured much more yield than where tobacco bonds were loosely valued just last week.

"The million dollar question is how well the California tobacco deal is going," a trader in New York said. "Tobacco bonds in the national market dropped two points this week and this deal just repriced the entire sector as people ask why they should pay 6.70% for New Jersey when you can buy California at 7%. People are hoping this deal is an aberration and that the bids will come back, but the sector has a major supply and demand problem. People know every state with a budget problem could bring a tobacco deal."

Bear, Stearns & Co. tentatively priced the $2.63 billion of **Golden State Tobacco Securitization Corp.** tobacco bonds with a top yield of 7% in 2041.

Long-dated tobacco bonds in the national market were loosely valued between 6.70% and 6.75% last week.

Serial bonds were priced to yield from 2.50% in 2006 to 5% in 2013. A 2021 term containing $248 million was priced as 5⅛s to yield 5.20%, a 2033 term containing $964 million was priced as 6¼s to yield 6.50%, and a 2039 term containing $930 million was priced as 6¾s to yield 7%. Finally, a 2041 term containing $415 million was priced at par to yield 7%.

The managers said they expected the bonds to be rated A1 by **Moody's Investors Service**, A by **Standard & Poor's**, and A-plus by **Fitch Ratings**.

Underwriters said they received $319 million of retail orders on the loan after a two-day order period on a scale featuring a top yield of 6.50% in 2041 with a 6¼% coupon.

Away from the California loan, market tone was firm in sympathy with government gains and underwriters reported improved follow-through new-issue business on some of the largest recent new issues.

"You've had Treasuries rally 20 basis points in the last couple of days and munis have gone nowhere, so obviously better governments are going to put a bid in the market," a trader in Chicago said.

Meanwhile, assets of the 536 tax-free money market funds tracked by iMoneyNet gained $2.48 billion to a new high of $292.56 billion for the week ended Jan. 13.

Assets of the 137 national retail tax-free money funds grew by $1.79 billion to $113.74 billion; assets of the 199 state-specific retail funds decreased by $655.6 million to $85.62 billion. Assets of the 116 national institutional funds increased by $1.45 billion to $77.50 billion; assets of 84 state-specific institutional funds fell $109.5 million to $15.70 billion for the week. Meanwhile, iMoneyNet said the tax-free seven-day yield plunged 20 basis points to a new record low of 0.54%. ❑

Virginia Governor Says $850 Million Tobacco Deal Likely to Happen by July

By Matthew Vadum

WASHINGTON — **Virginia** probably will go to market within the next six months with a much-anticipated tax-exempt tobacco bond deal that is expected to total roughly $850 million, Gov. **Mark R. Warner** said last week.

The governor made the remark in an interview with The Bond Buyer late Friday at his office in the state Capitol in Richmond.

The bond proceeds will be backed by half of the future payments from the state's share of the national tobacco settlement. Virginia is expected to receive about $4 billion through 2025 from the 1997 settlement.

The Virginia law, enacted nine months ago to authorize the bond sale, specifies that the proceeds are not be used for budget-relief purposes and are not to deposited into the state's general fund.

"I want to make sure that the commission has in place a solid plan, appropriate financial management, so that the dollars are well spent," said Warner, referring to the Tobacco Indemnification and Community Revitalization Commission, which will allocate the bond proceeds for indemnification payments to tobacco farmers, economic development, education, and training.

"This, in many ways, for southside and southwest Virginia, is their best hope for economic recovery," he said. Southside is the south-central part of the state that includes Pittsylvania, Appomattox, Mecklenburg, and Sussex counties.

"We'll be creating here a $500 million or $600 million economic development bank, and I want to make sure that there's the appropriate financial control and the appropriate expertise inside that economic development bank, and I'm very close to getting that comfort level that I need in order to move forward," Warner said.

Under the law authorizing the deal, the governor has sole discretion over the issuance of the tobacco bonds. "Once I pull that trigger it'll be up to [Treasurer] **Jody [M. Wagner]** and the team to go ahead and securitize," he said.

Last month, Virginia Attorney General **Jerry Kilgore** selected **McGuireWoods** LLP of Richmond as bond counsel for the state's upcoming tax-exempt tobacco bond deal.

Morgan Stanley has been tapped to run the books on the negotiated deal. ❑

THE WALL STREET JOURNAL

Monday, January 13, 2003

California to Sell $3 Billion in Bonds

Offering Is Largest Backed By the Tobacco Settlement; Aim Is to Help Close Deficit

By DAVID FELDHEIM
And STAN ROSENBERG
Dow Jones Newswires

NEW YORK—California today is expected to begin selling $3 billion of tax-exempt bonds backed by tobacco revenues to help the state close a gaping $35 billion budget deficit.

The sale, by a specially created entity, Golden State Tobacco Securitization Corp., would be the largest offering to date of securities collateralized by a state's share of the Master Settlement Agreement between 46 states and tobacco companies.

Bond Market Data Bank is on page C2 today.

Through some innovative features, the issue is designed to draw a wide range of buyers, including individuals.

For example, it includes $375 million of auction-rate securities, whose rates will be reset every 35 days, effectively converting long-term securities into short-term ones. That marks the first use of variable-rate debt in a tobacco securitization and lowers the cost to the issuer, said Daniel L. Keating, senior managing director of Bear, Stearns & Co., the deal's senior bookrunning manager.

The sale also will include about $2.625 billion of fixed-rate bonds.

A two-day order period for individual investors and for bank trust departments was to start today, Mr. Keating said, followed by an order period Wednesday for institutions.

Underwriters placed a full-page advertisement in Friday's Wall Street Journal, listing toll-free phone numbers for people to call who wanted copies of the preliminary offering circular. "We wanted to make sure we got everybody's attention," Mr. Keating said, and the phones have been "lighting up all day."

Golden State's security for the bonds will stem from about 54% of California's share of the 25-year Master Settlement Agreement. Other states, including cash-strapped New York, are also considering going down the same road.

Yield Comparisons
Based on Merrill Lynch Bond Indexes, priced as of midafternoon Eastern time.

	1/10	1/9	52-WEEK HIGH	52-WEEK LOW
Corp. Govt. Master	3.89%	3.92%	5.54%	3.65%
Treasury				
1-10 yr	2.38	2.42	4.20	2.11
10+ yr	4.95	4.97	5.96	4.49
Agencies				
1-10 yr	2.68	2.69	4.67	2.40
10+ yr	5.39	5.38	6.50	5.05
Corporate				
1-10 yr High Quality	3.61	3.64	5.37	3.37
Medium Quality	4.97	5.01	6.67	4.77
10+ yr High Quality	6.04	6.05	7.09	5.73
Medium Quality	6.86	6.89	7.93	6.65
Yankee bonds (1)	4.46	4.49	6.26	4.26
Current-coupon mortgages (2)				
GNMA 6.50% (3)	4.86	4.86	6.63	4.44
FNMA 6.50%	5.38	5.38	6.63	4.80
FHLMC 6.50%	5.42	5.41	6.64	4.83
High-yield corporates	11.08	11.13	13.96	10.92
Tax-Exempt Bonds				
7-12 yr G.O. (AA)	3.75	3.76	4.61	3.29
12-22 yr G.O. (AA)	4.71	4.72	5.29	4.32
22+ yr revenue (A)	5.00	5.01	5.44	4.61

Note: High quality rated AAA-AA; medium quality A-BBB/Baa; high yield, BB/Ba-C.
(1) Dollar-denominated, SEC-registered bonds of foreign issuers sold in the U.S. (2) Reflects the 52-week high and low of mortgage-backed securities indexes rather than the individual securities shown. (3) Government guaranteed.

Tobacco bonds must pay higher rates than ordinary state and local government bonds because they are riskier. Their payments are derived from sales of tobacco products. If cigarette consumption drops, the payment goes down too.

New Jersey sold $1.8 billion in similar bonds in August, a record at the time.

John Hallacy, managing director, municipal research at Merrill Lynch, said the need to attract greater retail participation was probably a key factor in the financing being structured with an auction-rate class of bonds.

The auction-rate notes would probably allow California to tap a different sector of the market, added Steven Mofitt, a director at Fitch Ratings.

Steven Levy, vice president of municipal research at Prudential Securities, said retail buyers are becoming a more important constituency for tobacco-backed debt. That's because many institutional investors don't want to take on more exposure to such securities.

"There's definitely capacity restraints," Mr. Keating said, "but California is special, and I think people will try to make room."

Ratings hadn't been assigned as of Friday afternoon, but Eric Hedman, an analyst at Standard & Poor's, said S&P was satisfied that the credits met the criteria for its single-A rating, the same it has assigned to other securitizations.

Mr. Mofitt of Fitch said that pending final documentation, he would assign an A-plus rating, also the same ranking the agency has given other tobacco issues.

Nicholas Weill, an analyst at Moody's Investors Service, said his agency would assign an A1 rating to the issue, also in line with its prior assessments of such issues.

The offering includes the two largest "turbo" fixed-rate long-term portions to date—for which an anticipated surplus of revenue enables accelerated repayment.

The projected final turbo redemption date for the 2033 bonds is June 1, 2016. For the 2041 notes, it is June 1, 2021. In addition to these bonds, the issue also was expected to include debt maturing from 2006 through 2013.

Estimates were that the bonds would be offered to individuals today at yields ranging from 2.50% in 2006 to 4.90% in 2013, and that the turbo maturities would return 6.20% for the 2033 issue and 6.50% for the 2041 bonds.

Friday's Market Activity

Treasurys, led by short maturities, gained on news that U.S. payrolls fell much more than expected in December. But much of the rally was said to reflect repositioning, rather than fresh buying, and some analysts said a closer look at the labor figures suggested that they weren't quite as gloomy as the headlines suggested.

At 4 p.m., the benchmark 10-year note was up 4/32 point, or $1.25 per $1,000 face value, at 98 27/32. Its yield fell to 4.144% from 4.158% Thursday, as yields move inversely to prices. The 30-year bond's price was up 9/32 point at 104 26/32 to yield 5.051%, down from 5.069%.

Prices rose after the Labor Department said nonfarm payrolls dropped 101,000 in December after a revised decline of 88,000 in November. Economists had forecast a December rise of around 30,000.

Friday's price gains did little to offset a dismal performance in previous days, resulting in the second straight week of declines. In fact, it was the worst start to January trading in more than 20 years, analysts said. The 10-year note yield has risen about a third of a percentage point since the year began.

Catalysts for selling have ranged from stronger performance by stocks, to the launch of about $25 billion in new corporate-bond issues and a fragile dollar.

In addition, the Treasury market already is focusing on the Treasury Department's February refunding auctions, and the possibility of larger issuance of Treasurys in the months ahead. Some in the market believe the Treasury might increase the frequency of issuance of five-year notes.

Perhaps the only real factor propping up the market, say analysts, is the uncertainty surrounding a potential war with Iraq. Based on that, some suggested the selloff in Treasurys may be overdone.

Meanwhile, the investment-grade corporate bond market took a breather Friday, with no new issuance. Nevertheless, it had been a busy week for new deals, with $17.4 billion through Thursday, according to Thomson Financial.

In trading, yield margins, or so-called spreads, for investment-grade corporate bonds were unchanged to about 0.05 percentage point narrower, said Jeff Ebert, a funds manager at US Bancorp Asset Management, Minneapolis.

However, spreads widened about 0.10 percentage point on Deutsche Telekom AG 10-year securities following Friday's downgrade of the company's long-term debt to Baa3 from Baa1 by Moody's.

Junk-bond prices were mostly unchanged, said traders.

—Steven Vames, Michael C. Barr and Richard A. Bravo.

FRONT PAGE - COMPANIES & MARKETS - Philip Morris abandons 2003 forecast.
By NEIL BUCKLEY.

11/13/2002
Financial Times
P17

Shares in **Philip Morris** tumbled almost 14 per cent yesterday after it abandoned its earnings forecast for 2003, warning it was being hit by cheap imports and counterfeit cigarettes.

The world's largest tobacco company it said it was "not in the position to confirm" its earlier projection of 8-10 per cent growth in underlying earnings per share next year.

But **Philip Morris** said it still expected to meet its recently reduced target of 3-5 per cent earnings per share growth this year. It would give guidance for 2003 at its next results announcement in January. The warning, to a Morgan Stanley investors' conference, came six weeks after **Philip Morris** said earnings growth this year would be much lower than its original expectations of at least 9 per cent.

Philip Morris shares closed at $37.03, and its rivals were also affected, with RJ Reynolds down 11.4 per cent at $37.83, and UST, the biggest US maker of snuff and chewing tobacco, down 7.5 per cent at $29.89.

The maker of Marlboro warned in September that a weak economy, rising excise taxes and "heightened consumer frugality" were driving smokers towards cheaper brands. That trend was fuelling the growth in cheap imports and illegal cigarette sales, and cut-price brands made by smaller manufacturers that were partly exempted from or not complying with the 1998 **Master Settlement Agreement** .

Under that arrangement, the big manufacturers agreed to pay about $250bn over 25 years to resolve lawsuits brought by the 50 US states. They have passed on much of the cost of their annual contributions to consumers, through higher prices.

Dinyar Devitre, **Philip Morris** 's chief financial officer, told investors yesterday US tobacco industry volumes were "softer than originally anticipated", citing cheap imports and counterfeit cigarettes as particular problems.

The company is pouring up to $650m into price promotions to try to tempt smokers back from its cheaper rivals.

The big tobacco companies are finding it difficult to push through the price increases they had grown accustomed to.

Martin Feldman, analyst at Merrill Lynch, reduced his earnings forecast for **Philip Morris** for next year. "We are becoming increasingly concerned about the ability of **Philip Morris** to take a pricing increase within its US tobacco unit in 2003," he said.
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THE BOND BUYER

Wednesday, October 2, 2002

Tuesday's Market

Munis Finish Down; Puerto Rico Sells $1.15B Tobacco Refunding

By Sean Monsarrat and Nicholas Chesla
The Bond Buyer Wire

Municipal bonds drifted lower yesterday as Treasuries fell and Puerto Rico issued the first tobacco refunding bond, totaling approximately $1.15 billion.

After a Monday rally, governments backtracked as stocks rose and the **Federal National Mortgage Association** said it no longer needed to buy as many Treasury bonds to replace inventory lost to increased mortgage prepayments.

Sellers also emerged after running the market up on Monday in advance of the Institute for Supply Management's manufacturing index, which dropped to 49.5% in September from 50.5% in August. The reading is the first below 50%, which indicates economic contraction, since January and the lowest since December.

In the municipal arena, yields rose anywhere from two to five basis points, depending upon name and structure, as governments declined although some market participants estimated yields up two to three basis points on average.

"The market opened with an easier tone and stayed that way," a trader in New York said. "It was very quiet."

Still, some market participants held to the notion that bonds would continue to benefit from investors seeking safety from stock market risk.

"I think the trade-off in bonds is just a correction in a rally," another New York trader said. "The market is still clearly in an up-trend and the stock market is still clearly in a down-trend. It seems like there's always some other shoe that drops that gets people's attention to get bonds to the upside again."

Nevertheless, some traders said retail investors were still stepping away from low absolute yields.

"It's hard to tell how much we're just reacting to the stock market, and we still have a fairly good level of interest in the market, but it's safe to say retail demand is off the highs," another trader in New York said. "Interest rates are shocking people and retail will continue to slow down unless we back way off."

In the new issue market, **Salomon Smith Barney** Inc. priced $1.15 billion of **Puerto Rico Children's Trust** tobacco settlement asset-backed refunding bonds with a top yield of 5.86% in 2043.

Serial bonds were priced to yield from 3.68% in 2008 to 4.54% in 2014. A 2033 term containing $465 million was priced as 5⅜s to yield 5.55%, a 2039 term containing $309 million was priced as 5 ½s to yield 5.78%, and a 2043 term containing $296 million was priced as 5⅝s to yield 5.86%.

The managers said they expect the issue to be rated A1 by **Moody's Investors Service**, A by **Standard & Poor's**, and A-plus by **Fitch Ratings**.

First Albany Corp. priced $250 million of **New York City Municipal Water Finance Authority** water and sewer system revenue bonds with a top yield of 4.04% in 2017.

Serial bonds were priced to yield from 1.62% in 2004 to 4.04% in 2017. Bonds due 2007 yielded 5 basis points more than Municipal Market Data's triple-A yield curve scale, bonds due 2012 yielded 15 basis points more and bond due 2017 yielded 4 basis points more.

The issue is rated Aa2 by Moody's and AA by Standard & Poor's and Fitch.

In the competitive market, Salomon Smith Barney bought $191 million of **Wisconsin** unlimited tax general obligation bonds at a sealed bid auction with a low interest cost of 4.13%.

The offering comprised serial bonds reoffered to investors at yields ranging from 2.18% in 2006 to 4.65% in 2023.

Bonds due 2007 yielded seven basis points more than MMD's Monday triple-A yield curve scale, bonds due 2012 yielded nine basis points more, bonds due 2017 yielded five basis points more and bonds due 2022 yielded 11 basis points more.

The issue is insured by **MBIA Insurance** Corp.

THE BOND BUYER

Monday, August 26, 2002

Friday's Market

Munis Close Trading Week Firm; S. Dakota Sells $278M in Tobacco

By Sean Monsarrat and Nicholas Chesla
The Bond Buyer Wire

Municipal bonds due in 20 years or more gained Friday in sympathy with a Treasury market rally, while South Dakota issued $278 million in tobacco bonds.

Governments rose for the first time in three days as a stock-market decline fueled demand for bonds. Yields on some municipal dollar bonds were quoted down one to three basis points in sympathy, although the market was little changed overall as the summer doldrums settled in ahead of the weekend and this week's Labor Day holiday shortened week.

In the new-issue market, **Bear, Stearns** & Co. tentatively priced $278 million of **South Dakota Educational Enhancement Funding Corp.** tobacco settlement asset-backed bonds. The offering comprised $149 million of noncallable taxable securities and a $130 million portion of tax-exempt debt priced as 6½s to yield 6.65% in 2032. The loan is rated Aa3 by **Moody's Investors Service** and A by **Standard & Poor's**.

In spite of Friday's price gains, triple-A municipal bond yields had risen roughly one to seven basis points on the week by the close Thursday, according to **Delphis Hanover** Corp. calculations, and an air of caution hung over the market as stocks showed more signs of life throughout the week.

"While the trend in equity flows is still negative, we suggest watching this closely," said a **Vestigo Associates** report by a research team led by **Thomas DeMarco**, certified financial analyst. "A turn in the moving average of equity flows would be decidedly negative to fixed-income product in our opinion, especially the retail-dependent muni market."

Exacerbating the underlying tension, the summer trading vacuum has severely limited price discovery, while Treasuries have been decidedly volatile. While muni bond funds continued to receive cash from investors this week and yields remain higher versus some other types of investments, the market appears at a standstill.

"Based on percentages to benchmark hedge products you would think this would be a good time to dip your toe in the water and buy bonds," a trader in Chicago said. "We're just not seeing enough follow-through. I think retail is staying in cash for the time being and I think the institutions are just waiting for things to calm down. We need a little stability because it's just been so choppy." ❑

THE BOND BUYER

Thursday, May 2, 2002

Wednesday's Market

Municipals Increase 1/8 to 1/4 Point; $1.6B Wisconsin Tobacco Deal Priced

By Sean Monsarrat and Nicholas Chesla, The Bond Buyer Wire

New issues, led by $1.6 billion in **Wisconsin** tobacco bonds, appeared to be well received by investors yesterday, while secondary-market prices firmed as Treasury bonds gained.

Government bonds climbed as stocks fell on signs of a sluggish economy reflected by a 0.9% drop in construction spending in March and a decline in the April Institute of Supply Management index to 53.9% from 55.6% in March.

Still above 50%, **Tim Rogers**, chief economist at **Briefing.com**, applauded the continuing expansionary trend in the ISM index, but said a short-term interest-rate hike was contingent upon evidence of increasing business spending.

"What we're seeing from the actual orders figures is flat demand and the absence of any real up-tick in business investment, and that's really what the Fed's waiting for before it starts to tighten policy," he said.

In the municipal arena, prices rose 1/8 to 1/4 of a point in spots as government bonds gained and investors continued to buy new issues and secondary bonds, especially due 15 years and less.

"Municipal bonds have developed a greater cachet than they have held in the past five years, and many asset-allocation models are finding that a combination of tax-exempt and alternative investments are striking a chord among individuals during the uncertainty of the U.S. economy," said **Thomas G. Doe**, president of **Municipal Market Advisors**, in a market strategy report.

Still, market participants remained cautious ahead of more incoming supply, dominated by a $2.87 billion **New York Metropolitan Transportation Authority** deal set for sale May 8, although the Wisconsin tobacco loan's success raised near-term price prospects.

"Badger [Tobacco Asset Securitization Corp.] got done at better levels than a lot of people thought possible," a salesperson in New York City said. "Size appears to be the answer, which means there are a lot of people waiting in the wings with cash."

Sellers were active throughout the session, circulating an estimated $300 million worth of bid lists, while offerings and institutional bids-wanted lists combined in the brokerage system of **Hartfield, Titus & Donnelly** LLC totaled roughly $4.2 billion after the close of futures trading.

In yesterday's primary, **Bear, Stearns** & Co. priced $1.6 billion of Badger TASC tobacco settlement asset-backed bonds for the state of Wisconsin, lowering yields by 5 basis points in 2005 and 2006 and by roughly 2 1/2 basis points in 2027 and 2032 at a repricing.

In the final offering, serial bonds were priced to yield from 3.45% in 2005 to 5.40% in 2012. A 2017 term containing $209 million was priced as 6s to yield 6.125% and a 2027 term containing $664 million was priced as 6 1/8s to yield 6.35%. A 2028 term containing $100 million featured a 7% coupon but was reported sold and not available. A 2032 term containing $422 million was priced as 6 3/8s to yield 6.60%.

The issue is rated A1 by **Moody's Investors Service**, A by **Standard & Poor's**, and A-plus by **Fitch Ratings**.

Merrill Lynch & Co. reoffered $68 million of top-rated Scottsdale, Ariz., general obligation bonds at yields equal to **Municipal Market Data**'s Tuesday triple-A scale, setting a top advertised yield of 4.90% in 2019.

Merrill won the issue at a sealed-bid auction out of nine bids with the lowest interest cost of 4.70%. **Salomon Smith Barney** Inc. had the next lowest interest cost of 4.72%.

The issue is rated triple-A by Moody's, Standard & Poor's, and Fitch.

Goldman, Sachs & Co. priced $467 million of **Brazos River Harbor Navigation District**, Tex., environmental facilities revenue bonds for the **Dow Chemical** Co. project, subject to the alternative minimum tax. Underwriters set a top yield of 6.625% in 2033.

The issue is rated A3 by Moody's and A by Standard & Poor's.

Moody's: Tobacco Bond Market Could Double in 2001

By Ryan McKaig

The tobacco bond market could increase 100% in 2001, to $5 billion from $2.5 billion, according to a report released yesterday by **Moody's Investors Service.**

"This issuance should include major transactions sponsored by various states as well as deals sponsored by certain counties or pools of counties," said Moody's analyst **Nicolas Weill**. "While most of the bonds are expected to be tax exempt, some will be structured for the taxable market."

Fitch analyst **David Litvack** also said he expected the tobacco bond market to grow in the coming year, saying the trend represents "a more favorable interest-rate environment for issuing debt in general."

Chris Howley, a structured finance analyst for **Standard & Poor's**, said that rating inquiries on tobacco deals have risen in the past six months as investors and issuers become more familiar with tobacco securitization deals, which Howley said resemble "a hybrid between structured finance and public finance."

The securitization of national tobacco settlement revenue was one of the major new developments in the asset-backed finance and public finance markets in 2000. Tobacco securitization deals are attractive, in part, because they can be used to finance all sorts of projects, from debt refunding to capital construction.

Tobacco settlement revenue securitizations are backed by future payments due under the Master Settlement Agreement — a deal reached in 1998 between the attorneys general of 46 states and territories, and the four largest tobacco manufacturers: **Philip Morris** Inc., **R.J. Reynolds Tobacco** Co., **Brown & Williamson Tobacco** Co., and **Lorillard Tobacco** Co..

"The MSA settled litigation between the states and the major tobacco manufacturers and represented the solution of a large financial liability of the tobacco industry for smoking-related health injuries," Moody's explains in its report.

Under the agreement, the tobacco companies are responsible for making several different types of payments to the states, called initial, annual, and strategic fund payments. The payments are based in part on consumption of tobacco products and can therefore vary from year to year.

Various counties and states have sold bonds backed by the payments, allowing them to access a new source of revenue. A group of New York counties, for instance, banded together last December to issue $227 million in pooled tobacco settlement asset-backed bonds.

The market is benefiting from what Moody's calls "positive trends in MSA litigation." The agency notes that all legal challenges to the MSA have thus far been defeated.

The most recent tobacco bond deal is a $28 million offering by the **Ulster County, N.Y., Tobacco Settlement Asset Securitization Corp.**, which priced and sold last week. **Dan Tomson** of **Salomon Smith Barney** Inc., which served as underwriter on the deal, said there was "very strong retail demand" for the bonds. ❑

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The Bond Buyer

THE DAILY NEWSPAPER OF PUBLIC FINANCE

Tuesday, October 10, 2000

Airports in Need of a Lift

Memphis Authority Advocates a PFC Hike

By Humberto Sanchez

WASHINGTON — Even though an increase in the airport passenger-facility charge was enacted into law earlier this year, a Memphis airport executive told Congress last week that additional hikes in the cap on PFCs should be approved to provide the funds needed to increase the capacity of the nation's airports.

Testifying amid growing public complaints over congestion and delays at numerous airports, Larry D. Cox, president and chief executive officer of the Memphis-Shelby County Airport Authority, told the House Transportation and Infrastructure Committee's aviation subcommittee that "funding for airport capacity should be a top priority in the future, with increased authorization levels and annual appropriations of Airport Improvement Program funds and additional increases in the cap on PFCs for airfield capacity projects."

Inside: Hospitals Gain Allies in Drive for Relief from Federal Cuts. Page 5

The Memphis airport authority's Larry Cox told Congress "funding for airport capacity should be a top priority" and that another PFC hike is needed.

Cox's comments, which did not specify how high or when the PFC should be raised again, came as officials of five airports from Massachusetts to California discussed the challenges of building new runways, particularly the problems of satisfying environmental requirements.

Cox's request for another hike in

Please turn to Airports page 7

'Turbo' Plan Accelerates Alaska Deal

Tobacco Debt Could Be Repaid by 2013

By Deborah Finestone

SAN FRANCISCO — Alaska, the first state to securitize a portion of its share of the national tobacco settlement will also be the first municipal issuer to use a so-called full turbo structure to accelerate the repayment of those bonds, investment bankers involved in the deal said late last week.

The Northern Tobacco Securitization Corp., which was established by the Alaska Housing Finance Corp. specifically for the deal, plans to sell $116.4 million in bonds Thursday. Bear, Stearns & Co. will be the book-running senior manager.

Although the bonds will have maturity dates until 2030, Kym Arnone, senior managing director at Bear, Stearns, said the bonds are expected to be paid off in 13 years. That's because of the special mandatory redemption feature, in which any settlement payments not necessary to pay debt service in a given year will be used to retire debt on an accelerated basis. The "turbo" moniker comes from the structured finance market, where the provision is common.

"No residuals flow out to the state until all the bonds have been paid off

Please turn to Alaska page 35

Salt Lake City Learning About The High Cost of Olympic Gold

By Elizabeth Albanese

DALLAS — Now that the Olympic flame has been extinguished in Sydney, Australia, Salt Lake City has only 486 days left to get the 2002 Winter Games up and running. Meanwhile, Salt Lake and other future host hopefuls scramble to find what it takes to put on "the best Games ever." ... projects before they make bids for the 2012 Summer Games.

The International Olympic Committee requires cities that host the Games to have ample infrastructure in place — streets, transit systems, parking, and water supplies, as well as venues for the events. The IOC has the power to take the Olympic Games away from a chosen host city if those

The Regions

Alaska to Use 'Turbo' Structure To Speed Up Tobacco Repayment

Continued from page 1

in full," she said.

Overall, the NTSC is securitizing 40% of the settlement, which is expected to generate a total of $25 million annually for the next 25 years, according to **John Bitney**, legislative liaison for the housing corporation.

About $30.15 million of serial bonds maturing from 2008 to 2013 will not be subject to the accelerated redemption. The projected average life of a $35.465 million term bond due in 2020 is 6.4 years, and the $50.8 million 2030 term is expected to be retired in 13 years.

The underwriters believe the early redemption will offset some of the risks associated with the tobacco industry, including decreasing consumption, future litigation, and bankruptcy, Arnone said.

This structure should appeal to investors while being economical for the NTSC, according to the corporation's financial adviser, **Steven Kantor**, president of **Arimax Financial Advisors.**

"We believe this [structure] will result in the quickest repayment of the debt and thus will result in a lower cost of borrowing for the corporation," he said. "The structure is easy to explain to investors. We're trying to attract people who have already invested in tobacco securities to date, and new purchasers who may feel this structure is superior to others out there."

The structure is also familiar to the issuer, since the staff of the NTSC overlaps with the housing corporation, Kantor said. Housing agencies are used to fast-amortizing structures like super-sinker bonds.

The corporation is dedicating $93 million of the proceeds to construct facilities for public schools, the University of Alaska, and ports and harbors, as specified by the Legislature and Gov. **Tony Knowles** back in June. The remaining proceeds will create a reserve fund and pay for costs of issuance. Knowles originally proposed securitizing the state's whole share of the settlement, but the Legislature opted to only securitize a portion.

The bonds will be an obligation of the NTSC only, not the state or the housing corporation.

Standard & Poor's assigned an A rating to all maturities, citing the overall strength of the collateral, bonds' structure, and an adequately sized reserve. Since the agency rates the ability to pay until the bonds' official maturities, in this case 2030, the rating accounts for various credit risks of the tobacco industry.

But the unique highlight and strength of this particular deal is the 100% turbo redemption, said **Peter Block**, associate director of housing and structured finance for Standard & Poor's.

"If everything goes as they expect, revenue will be available to retire term bonds earlier," Block said. "The full turbo feature partially offsets some of the uncertainties relating to cigarette consumption forecasts."

The liquidity reserve is equal to maximum annual debt service, strengthening the deal's credit.

Fitch had not officially released its rating on this issue at press time. However, **David Litvack**, managing director at Fitch, said the rating will be similar to other tobacco deals, which Fitch has rated A-plus.

"We view ratings on tobacco deals as based on the credit of the tobacco industry, which may be enhanced somewhat based on the nature of the master settlement agreement," Litvack said. "The structure of a deal won't help the rating from Fitch's point of view."

Arnone anticipated an Aa3 rating from **Moody's Investors Service**, but no official information was available at press time.

"We're trying to attract people who have already invested in tobacco securities to date, and new purchasers who may feel this structure is superior," says Arimax's Steven Kantor.

San Francisco Chronicle

NATION & CALIFORNIA

Nationwide Class Action Sought Against Tobacco

Lawyers want merger of punitive claims

By Henry Weinstein
LOS ANGELES TIMES

A group of the country's leading plaintiffs lawyers asked a federal judge in New York yesterday to create a nationwide class action to consolidate all punitive damage claims against cigarette companies – a bold strike that may set the stage for a huge verdict.

Some analysts said the move could ultimately be in the interest of the tobacco companies even though a nationwide class action could potentially lead to a verdict or settlement greater than the $145 billion recently awarded in a Florida class action now on appeal.

The potential advantage to the companies is that a nationwide case could lead to a settlement that would provide them the sort of financial certainty they have been seeking in attempts to resolve tobacco lawsuits.

For now, however, the companies are having none of it, decrying the suit as an attempt to gain a settlement through blackmail and scoffing at the idea that it could lead to a major resolution.

"We will oppose any effort to certify any of these cases as class actions," said William S. Ohlmeyer, vice president and associate general counsel of Philip Morris, the nation's leading cigarette-maker. "Two dozen state and federal courts in other cases have concluded that you can't treat tobacco cases as class actions."

A class action could be created over the industry's objections, although that could lead to appeals, which could drag on for many years. The federal district judge in the case, Jack B. Weinstein of New York City's Brooklyn borough, virtually invited the plaintiffs lawyers to file the case in his court.

Yesterday's suit – which in some respects is highly unorthodox – is another sign of the creative attempts by plaintiffs lawyers to generate a sweeping climax to the biggest-money litigation in history.

The tobacco industry already has agreed to settlements that commit cigarette companies to pay nearly $250 billion over 25 years. But the industry still faces a bevy of other lawsuits that have forced the companies to spend hundreds of millions of dollars to defend themselves and have depressed their stock prices.

The move is in part a response to the Florida verdict earlier this year. Tobacco company lawyers have expressed confidence that the $145 billion punitive damage verdict in that case will be overturned. But even if it is, cigarette companies face upcoming trials in West Virginia and Louisiana that also could yield large punitive awards, according to Professor John Coffee of Columbia Law School.

If that happens, the cases could result in "a run on the (tobacco industry) bank" in which citizens of some states win big awards that wipe out the ability of anyone else in the country to receive damages, Coffee wrote in a recent law review article. A consolidated punitive damages settlement could lead to a more rational allocation of money, he wrote.

Coffee has been retained by Weinstein to assist him in trying to reach a resolution of the tobacco cases. Weinstein, who has long experience with mass injury cases, has handled suits involving asbestos and Agent Orange and currently has 10 tobacco suits pending.

The suit filed yesterday is particularly unusual in that it does not seek punitive damages for individuals.

Under the proposal, existing compensatory damages cases for individuals would go forward separately. And any punitive damages awarded would not go to individuals. Instead, the money would be placed in a fund to be used for "the greatest possible public benefit," such as medical and scientific research and public health programs.

"This suit raises a host of difficult questions," said Alan Morrison, the director of the Public Citizen Litigation Group, an organization that has frequently challenged class action settlements on the grounds that they are unfair to victims.

With tobacco cash in jeopardy, some states seek to cut losses

ASSOCIATED PRESS

April 2000
Reno G-J

HARRISBURG, Pa. — State governments fearful of losing billions in tobacco settlement money are scurrying to find ways to keep the cash coming in the face of lagging cigarette sales and high-stakes litigation in Florida.

The states already took a billion-dollar hit this month after their payments were decreased to reflect last year's 9 percent decline in U.S. cigarette shipments. Pennsylvania received $198 million, about $28 million less than projected, and other states reported similar declines of 10 percent to 15 percent.

The losses, which some state officials say may continue, could shave more than $20 billion from the $206 billion due to 46 states over 25 years to cover health-related costs, under a "volume adjustment" clause of the settlement agreement.

Even worse, states worry that payments could be delayed for years in the event of a crippling punitive award in a Florida class-action lawsuit involving an estimated 500,000 sick smokers.

It's a potential problem for many states, which are using their cut of the settlement to pay for projects ranging from smoking prevention programs and health insurance for the uninsured to schools, water projects and new jails.

With so much at stake, state governments are keeping close watch on the health of the very industry at the core of the health-related problems to begin with.

"I do think state appropriators have been very cautious where they put these dollars, knowing they're going to change," said Joan Henneberry, a health policy expert at the National Governors Association.

Many states, like Pennsylvania, want to cushion the impact of fluctuating payments with plans to set aside portions in rainy day funds and by appropriating the settlement money for programs year by year.

Other states are bolder. Four tobacco states — Georgia, Kentucky, Virginia and North Carolina — have passed or are pondering bills to shield industry assets during the appeals process. That came after some analysts predicted record damages in Florida and as the Justice Department sues the industry to recover billions the government says it spent on smoking-related health care.

And a few states, including Florida, Virginia and Louisiana, cite the declining payments and the industry's bankruptcy risk for why they may sell some of their settlement to investors at a discount. They say it's better that counting on the industry to stay fully afloat for 25 years.

"We can't afford to take that risk," said Louisiana State Treasurer John Kennedy. "If your rich uncle died and left you $4.6 billion, you wouldn't buy all Philip Morris stock; you'd diversify. ... But every day we wait and more bad news comes out about the tobacco industry, the price goes down."

Under the settlement signed in November 1998, the tobacco companies agreed to pay 46 states for smoking-related health costs. The companies earlier signed separate deals, also with "volume adjustment" provisions, with Mississippi, Florida, Texas and Minnesota for a combined $40 billion.

The agreements forced companies to end billboard advertising and certain other marketing tactics, such as cartoon images like Joe Camel. Companies then raised cigarette prices about 45 cents per pack to help pay for the settlement, leading to about a 9 percent decline in shipments last year, analysts say.

Analysts don't expect similarly sharp sales declines in future years — one projected a 1 percent to 2 percent drop annually. But they are encouraging state governments nevertheless to consider ways to minimize risk, either by legislating against the impact of large damage awards or selling some of their shares to investors.

"It would be imprudent for any state not to consider the best ways of protecting the annual revenues to that state," said Martin Feldman, an analyst with New York-based Salomon Smith Barney.

Pennsylvania Attorney General Mike Fisher, a member of the committee that negotiated the multistate settlement, said the best way to cushion the impact of fluctuating payments is to devote funds to health care, the costs of which will decrease as smoking levels dwindle.

"We shouldn't be concerned that the amount of cigarettes being sold is going down," he said. "It's a good sign and the primary goal behind bringing this litigation in the first place."

Anti-tobacco activists, meanwhile, worry that exaggerated fears of losing settlement payments may undermine anti-smoking efforts.

Even if smoking were reduced by only 1 percent annually for five years, they said, the country would save billions of dollars that would otherwise go toward treating smoking-related heart attacks, strokes, low-birthweight babies and other costs.

"I do think that so far there has been much too much focus on lost settlement revenues and too little on the benefits from reduced smoking levels," said Eric Lindblom of the Campaign for Tobacco-Free Kids.

States Fearing Tobacco Industry Bankruptcy

Damages in Florida suit may be huge

By Henry Weinstein and Myron Levin
LOS ANGELES TIMES

State attorneys general are taking the extraordinary precaution of hiring bankruptcy lawyers out of fear that a colossal damage award in a Florida class action could lead to a tobacco industry bankruptcy and stop the flow of settlement payments to the states.

Christine Gregoire, Washington attorney general, said a panel of attorneys general will be interviewing bankruptcy counsel tomorrow, adding that the states "have every intent of . . . holding (cigarette-makers') feet to the fire" regarding payment obligations under $246 billion in settlements reached in 1998 with the states.

Although the tobacco industry has not said it would seek bankruptcy protection, talk of bankruptcy stems from the threat of a punitive damages award that could reach into the hundreds of billions of dollars in the Engle class-action case, which is nearing a critical phase in Dade County Circuit Court in Miami.

Industry representatives "have clearly stated to us that they are concerned about . . . a large punitive damage award, and what that would mean to them as companies," Gregoire said.

A record-breaking damage award is widely anticipated because jurors in the case already have found cigarette-makers guilty of lying to the public about the risks and possibilities of addiction to smoking. Under a trial plan bitterly protested by the industry, the same jury is soon expected to decide whether punitive damages should be assessed in a lump sum to an immense class of current and former Florida smokers, rather than considering their cases one at a time.

Although tobacco officials and Wall Street analysts have said they believe the industry would have a good chance of prevailing on appeal, the companies would face the immediate problem of posting an appeal bond to cover an award that many think may reach or exceed $100 billion.

Under the law in Florida and many other states, in order to forestall collection of a judgment, the losing party is required to post a bond to cover the full amount of damages plus interest to cover the period of the appeal. And despite their enormous cash flow, cigarette-makers don't have that kind of money laying around, which is causing the bankruptcy buzz.

But at the behest of tobacco producers, legislatures in four states — Georgia, Kentucky, Virginia and North Carolina — have recently passed or are being urged to take up bills that limit the financial requirements a defendant must meet during the appeal process.

Citing a gag order imposed by Engle trial Judge Robert Kaye, spokesmen for the nation's three leading cigarette manufacturers — Philip Morris, R.J. Reynolds, and Brown & Williamson Tobacco Corp. — all declined comment.

Tobacco industry analyst Martin Feldman of SalomonSmithBarney said he did not expect bankruptcy filings but acknowledged the subject was being widely discussed in investment circles. He said the prospect of a huge damage award had so deeply depressed tobacco share prices that it was as if the market anticipated a bankruptcy.

The stakes are high for the states too. Although health advocates have bitterly complained that few states have earmarked significant settlement funds for anti-smoking efforts, a host of other new programs — ranging from health care and public works to tax relief — now depend on tobacco payments.

Now well into its second year of trial, the Engle case, named for Miami physician Howard Engle, seeks damages for a large class of current and former Florida smokers possibly numbering in the hundreds of thousands.

In a landmark verdict last July in the first phase of the case, the six-member jury found that smoking was addictive and the cause of a variety of deadly diseases. Jurors also concluded that cigarette companies "engaged in extreme and outrageous conduct," including lying about the dangers and addictive nature of their products, and thus were generally liable for injuries to smokers.

Closing arguments are set fo March 27 in the trial's second phas — the mini-trials of three class repre sentatives who blamed their cancer on smoking.

The New York Times contributed to th report.

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Happy Holiday Shopper's GIFT GUIDE

Inside

Dallas beats the Dolphins 20-0

sports
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Sales affect tobacco payouts

Associated Press

HARTFORD, Conn. — States are slated to get less money from the tobacco settlement than initially thought, because of an expected nationwide decrease in cigarette shipments.

Under a little-noticed "volume adjustment" provision of the settlement, Connecticut stands to see up to 10 percent less than the $166 million it expected to collect between now and April, said Marc Ryan, the director of the governor's budget office.

Other states also stand to come out with less money as tobacco shipments and sales decline because of high price increases and anti-tobacco campaigns that started after cigarette makers settled lawsuits with the states last year.

The exact reduction has not yet been calculated. It will affect settlement payments due to states in April. The situation puts some state budget-crunchers in limbo as they plan to spend money they do not yet have on everything from education and health care to new roads and prisons.

"Frankly, the prudent thing to do is not to spend specific dollars until they see what they will be," said Laurie Loveland, a lawyer who helped negotiate the tobacco settlement for the North Dakota attorney general's office. "I think it's a mistake for state legislatures to become addicted to the tobacco money."

Tobacco companies agreed to pay around $206 billion over 25 years to settle lawsuits against them by Connecticut and 45 other

Please see TOBACCO, A10

Tobacco

Continued from Page A1

states over the costs states incurred to treat sick smokers.

Tobacco opponents said the decreased payout underscores the need for more of the settlement money to be spent directly on health care and anti-smoking campaigns instead of other state needs.

"The portion of money that has been allocated for tobacco prevention is less than 2 percent of the total money coming into the state, so I would certainly hope the minimal amount we are receiving would be the same," said Rochelle Ripley, the spokeswoman for Connecticut's anti-tobacco MATCH Coalition.

Dow Jones Business News

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RJR To Sell International Unit, Spin Off Domestic Tobacco Business

03/09/1999
Dow Jones Business News

NEW YORK -(Dow Jones)- **RJR** Nabisco Holdings Corp. Tuesday said it will sell its international tobacco unit to **Japan Tobacco** Inc. for $7.8 billion and separate its domestic tobacco business from its Nabisco food operations.

The sale of the international tobacco unit had been widely expected, but the board's endorsement of a spinoff of **RJR** 's domestic tobacco business, R.J. Reynolds Tobacco Co., came as a surprise.

The sale and spinoff break up the company formed almost 15 years ago by the combination of R.J. Reynolds and Nabisco Brands. Investment firm Kohlberg Kravis Roberts & Co. acquired the combined **RJR** Nabisco for $25 billion about 10 years ago. At the time, it was the biggest deal ever.

RJR 's top executives have been under pressure from Carl Icahn and other shareholders to boost the company's stock price by separating the company's tobacco and food interests. Icahn owns at least 7.7% of **RJR** and had threatened a proxy fight to elect new directors who would be willing to pursue a split. Chief Executive Officer Steven Goldstone had resisted, however, expressing concern that a spinoff could subject the company and its directors to civil charges that they channeled money to holders that belongs to plaintiffs in tobacco suits or settlements.

In midday trading on the New York Stock Exchange, shares of **RJR** (RN) were up $1.50, or 5.2%, at $30.125 on volume of 5.4 million, compared with the daily average of around 1.8 million.

RJR Nabisco said that, assuming final approval by the board, the separation of R.J. Reynolds will be accomplished by a tax-free spinoff to shareholders of the domestic tobacco business. R.J. Reynolds, the maker of Winston, Camels and Salem cigarettes, is the No. 2 tobacco company in the U.S. behind Philip Morris Cos. (MO), the maker of Marlboro.

After the spinoff is completed, **RJR** Nabisco will continue to exist as a holding company, owning 80.6% of Nabisco Holding Corp. The company will be renamed Nabisco Group Holdings. The renamed entity and Nabisco Holding Corp. will each continue to trade as separate companies on the NYSE. R.J. Reynolds, which had total revenue of $5.6 billion last year, will be based in Winston-Salem, N.C.

R.J. Reynolds is among the four major U.S. tobacco companies that recently agreed to pay a total of $206 billion over 25 years to settle claims by 46 states for the treatment of smokers with health problems. In light of the settlement, the Federal Trade Commission dropped its Joe Camel advertising case against R.J. Reynolds. The FTC had charged that the ads unfairly targeted underage smokers, but said in January that the settlement affords most of what it wanted from Reynolds - a ban on cartoon characters in ads and a $1.5 billion and a five-year antismoking campaign.

RJR Nabisco said it will outline the specifics of the spinoff after the sale of the international tobacco business is completed.

RJR has been searching for a buyer of the international unit for months and said it was negotiating with a number of companies. The Wall Street Journal reported Tuesday that **RJR** Nabisco shares rose in the past few weeks on expectations that a deal was imminent.

According to the terms of the pact, **Japan Tobacco** will acquire all of the business and trademarks of R.J. Reynolds, including the international rights to Camel, Winston and Salem cigarettes. The deal includes the assumption of $200 million of debt. The purchase price was higher than the $6 billion to $7 billion price tag forecast by industry observers, and it is believed to be the largest acquisition price ever paid by a Japanese company.

Japan Tobacco is Japan's former tobacco and salt monopoly. Privatized in 1985, it now makes tobacco products and is diversifying in pharmaceuticals, food, agribusiness, real estate and engineering. It posted an unconsolidated net profit of 108.9 billion yen ($895.8 million) in the 1997 fiscal year, which ended March 31, 1998, on sales of 2.62 trillion yen. The Tokyo-based company employs 20,000 workers.

Tobacco demand is considered to have peaked in Japan and opposition to smoking is growing, so **Japan Tobacco** has been focusing its overseas business operations on sales in East Asia. The purchase of **RJR** Nabisco's international tobacco business is expected to help it penetrate promising markets in Eastern Europe and other regions, Kyodo News reported Tuesday. With the purchase, **Japan Tobacco** will sell 460 billion cigarettes a year, Kyodo said.

Japan Tobacco 's president, Masaru Mizuno, said the deal will allow **Japan Tobacco** "to acquire many international business bases in a single stroke and face the competition as a world-class player."

RJR Nabisco said it will use the proceeds from the sale to reduce debt as well as for general corporate purposes, enabling it to strengthen the financial position of Reynolds Tobacco Co.

The sale, which **RJR** said it hopes to complete within two months, is subject to certain regulatory conditions and receipt of certain consents from **RJR** Nabisco's bondholders.

Goldstone said last month that boosting the international tobacco business was a top priority for the first half of the year. Reynolds International is far behind market leaders Philip Morris Cos. and British-American Tobacco PLC (BTI), and its earnings have fallen amid the economic turmoil in Russia and Asia.

The plan wouldn't fundamentally change the food company but could make its takeover target, analysts said. "In its simplest form, the company has changed the form and not necessarily the substance from a Nabisco shareholder's point of view," said Merrill Lynch analyst Leonard Teitelbaum. "Stock ownership, voting rights and the dividend policy remain intact. The change is primarily at the tobacco-company level."

Goldman Sachs & Co. analyst Naomi Ghez said the tobacco sale and spinoff could raise the possibility of a takeover attempt. Many market players have wondered whether Nabisco would be a takeover target if it could dissolve its relationship with tobacco. "Assets in the food industry are very valuable ... and Nabisco is very attractive given its strong market share," Ghez said. But for now, the forthcoming separation will enable Nabisco to "use its cash flow better," Ghez said.

The cookie and cracker maker is just beginning to revive after a period of slowing volumes and sales. "On a fundamental basis, Nabisco's core biscuit business has exhibited significant turnaround vis-a-vis volumes," Teitelbaum said.

The plans announced Tuesday mark the latest in a series of changes the company has weathered over the past two decades. The firm labored under the tarnished image of the tobacco industry while pulling off mergers, stock offerings and one memorable leveraged buyout.

The Nabisco and **RJR** brands were first joined in 1985, when storied tobacco maker R.J. Reynolds bought Nabisco Brands Inc. for $4.9 billion. For Reynolds, a company that traced its origins back to 1875, the move was about diversifying into the attractive consumer-products industry and strengthening its international presence. Nabisco, owner of well-known brands such as Oreo Cookies and Ritz Crackers and with more than one-third of its sales coming from overseas, was a perfect fit.

Nabisco CEO F. Ross Johnson became president and chief operating officer of the combined company. But Johnson had already prospered from another big merger - Nabisco's 1981 acquisition of food-industry giant Standard Brands Inc. - and it didn't take very long for him to take over the reins at Reynolds. Once at the top, he became obsessed with trying to lift **RJR** Nabisco's stock, which he considered undervalued. Eventually, a deal-hungry Johnson concluded the stock market wasn't valuing the company fairly and decided a management-led leveraged buyout would be a good way out.

But other bidders surfaced soon after Johnson made his intentions public in late 1988, and the ensuing melee led to what some consider the most memorable takeover in history. By the time it was over, the fight for **RJR** Nabisco - chronicled in the best-selling "Barbarians at the Gate" and later in a movie based on the book - had become a symbol of 1980s greed.

The battle was eventually won by Kohlberg Kravis Roberts, which beat out Johnson's team. **RJR** Nabisco didn't stay private for very long. KKR sold off some units and had **RJR** Nabisco back in the public markets by 1991. But the company continued to face the same problem that dogged Johnson as investors punished the stock for its tobacco link. Trying to get more value out of the food business, **RJR** Nabisco eventually spun off part of it as Nabisco Holding Corp. (NA) through a public offering.

RJR Nabisco faced other challenges through the 1990s. The tobacco industry's future became clouded by lawsuits filed by consumers and by states seeking to recover Medicaid funds spent on treating sick smokers. The legal challenges led to a $206 billion settlement of the lawsuits of 46 states, but the federal government may also file a lawsuit.

Tobacco Settlement Payments Securitization

Frequently Asked Questions and Answers

What is the Master Settlement Agreement (MSA)?

The MSA is an agreement among 46 states and the major United States tobacco manufacturers that settled state litigation against the manufacturers. The MSA provides for payments to the states based on domestic cigarette consumption. The MSA payments are subject to a number of adjustments and the annual amounts will vary.

What is a securitization?

A securitization is a form of financing that is supported by the sale of an asset. The owner of the asset sells the asset to a third party, and the third party raises funds for purchase of the asset through the issuance of securities. Here, the State of Nevada (the owner) is selling a portion of the MSA payments (the asset) to the Tobacco Settlement Financing Corporation or TSFC (a third party) and receiving an up-front amount plus annual residual payments.

What type of assets may be securitized?

Contractually obligated payment streams may be securitized. Mortgage payments are an example of an asset stream that may be securitized.

What is the TSFC?

The TSFC (Tobacco Settlement Financing Corporation) is a not-for-profit entity created as a limited purpose, bankruptcy remote entity authorized to issue bonds to finance the purchase of the tobacco settlement payments, or portion thereof, from the State.

How will the TSFC raise the money to purchase a portion of the tobacco settlement payment stream?

The TSFC will be authorized to issue nonrecourse securities or bonds, to raise the funds needed to purchase the asset.

Who will be members of the TSFC and who will staff the TSFC?

The TSFC Board will consist of several members, including the State Treasurer. The Office of the State Treasurer will staff the TSFC.

What is a residual?

The residual is the difference between the annual MSA payments received by the TSFC and the debt service payments on the TSFC bonds. The State will receive a residual payment in a particular year to the extent the MSA payments in such year exceed the TSFC bonds' debt service in such year. The size of the residual in each year will depend on the MSA payments for that year.

Tobacco Settlement Payments Securitization

Frequently Asked Questions and Answers

Why should Nevada securitize the tobacco settlement payments?

The tobacco settlement payments are an unusual revenue source that result from a unique event: a settling of claims by states against the tobacco manufacturers. The amount of settlement payments is determined according to a complex formula tied to several variables, including volume of cigarettes sold in the United States. The sale will reduce Nevada's exposure to MSA payment risk, a type of investment risk not generally associated with the State.

What is MSA payment risk?

The domestic tobacco industry is subject to the risk of litigation, regulation and cigarette smoking trends, each of which may reduce cigarette consumption, which reduces MSA payments. Consideration of all these risks is incorporated in the securitization proposal, including anticipated reductions in consumption. Even with the risks, tobacco industry analysts believe that the tobacco industry credit is generally strong.

Has anyone else securitized tobacco settlement payments?

Yes. Seven New York localities have completed transactions totaling about $1.5 billion, including New York City, who completed the first transaction in November 1999 for $709 million. A $32 million sale was issued by North Dakota in March of 2000, a $50 million sale by the State of Alabama in September 2000 and a $116 million sale was done for Alaska in October of 2000. The Commonwealth of Puerto Rico issued $397 million in tobacco settlement asset-backed bonds in October of 2000 and the Tulare County Public Financing Authority in California issued $45 million in variable rate lease-backed revenue bonds in order to capture the revenue stream from the tobacco settlement to cover the debt service.

Are the TSFC bonds considered debt of the State?

No. The TSFC bonds are solely obligations of the TSFC and secured by the revenue stream (the tobacco settlement payments) purchased by the TSFC. The State is not obligated in any way to make debt service payments on any bonds issued by the TSFC.

Will the TSFC bonds be rated?

Yes. The TSFC bonds will likely be rated by the major rating agencies that rate the State's debt. The tobacco bonds already sold have received investment grade ratings of single-A and, in some cases, double-A. Similar rating levels are anticipated for the TSFC bonds.

How are bond ratings determined?

The rating agencies evaluate numerous factors to determine the ratings for any bonds, including the TSFC bonds. Factors that will determine the credit rating on the TSFC bonds include the final structure of the transaction, the term of the bonds, coverage levels, the predictability of the underlying tobacco settlement payment stream and other factors. The actual ratings of the TSFC bonds will be determined just prior to sale.

Tobacco Settlement Payments Securitization

Frequently Asked Questions and Answers

Are single-A and double-A ratings acceptable ratings?

Yes. Single-A and double-A ratings indicate a strong credit and are considered solid investment grade ratings.

I know the State is currently rated Aa2. Will issuance of the TSFC bonds affect that rating in any way?

No. The TSFC bonds are not bonds of the State, do not constitute an obligation of the State and will not affect the State's general obligation bonds.

What is debt service "coverage"?

Coverage is the amount by which projected cash flows (MSA payments) exceed annual debt service on the TSFC bonds. For example, if annual revenue is estimated to be $100 and annual debt service is $10, then the transaction would have a coverage ratio of 10x. The higher the coverage on a transaction, the lower the risk to the bondholders and the lower the cost to the borrower. High coverage protects bondholders and enhances ratings.

What if MSA payments decline over time?

The stream of payments to the TSFC would decline proportionally. The annual residual payments to the State would also be affected. A number of protections for bondholders will be incorporated into any sale; however, under no circumstance would the State be obligated to make debt service payments on the bonds. Ultimately, the risk of a decline in the MSA payments is shifted from the State to investors in the TSFC bonds.

How long are the tobacco companies obligated to make payments under the MSA?

The MSA provides for payments to the states in perpetuity.

We are used to seeing State debt with level debt service payments. Why does the projected debt service for TSFC bonds fluctuate?

The proposed TSFC bond debt service is structured to mirror a percentage of the estimated cash flows (MSA payments) of the tobacco settlement payments, which are projected to fluctuate over time.

What is the cost to the State for the sale of tobacco settlement payments?

The cost of the sale consists of the interest cost associated with receiving a present value benefit and the costs of issuance of the bonds. Both of these costs would be incurred in any financing by the State. The present value difference between receiving the MSA payments annually over time and completing the securitization is minimal.

Tobacco Settlement Payments Securitization

Frequently Asked Questions and Answers

Will the TSFC bonds be more expensive than State debt?

Yes, given the greater credit risk perceived by investors from debt supported by settlement payments from tobacco companies rather than the State. The TSFC bonds likely will have a higher interest rate than the State's bonds. Typically the State's revenue bonds have a higher interest cost than its general obligation bonds. The higher the credit quality or ratings of a bond, the lower the cost of interest.

Why not just sell State general obligation bonds to be paid from the MSA payments?

The State would be absorbing, rather than selling, MSA payment risk since general obligation bonds must be paid by the State under any circumstances. General obligation bonds are subject to constitutional debt limits. Finally, general obligation bonds constitute tax-supported debt of the State and would impact the State's credit rating and debt capacity.

Will the TSFC bonds be tax-exempt?

No, since the proceeds of TSFC bonds are used to finance programs, the bonds will be issued as taxable obligations.

Who will buy the TSFC bonds?

The same type of investors that regularly purchase other municipal debt will be interested in the tobacco bonds—individual investors, insurance companies, bond funds and trust departments. Such investors are willing to incur the risk of reduced MSA payments over time in exchange for a slightly higher interest rate on the bonds. The completed transactions to date have established significant investor interest in this type of financing.

Definition of Key Terms

- ***Adjusted Payments:*** Projected tobacco settlement payments adjusted according to econometric projections of cigarette shipments and inflation.
- ***Equity:*** A security representing residual ownership in a corporation.
- ***Fixed Income:*** A security, such as a note or a bond, that pays a guaranteed rate of interest.
- ***Present Value:*** The value today of a future stream of payments at an assumed interest rate.
- ***Securitization:*** The process of issuing bonds to receive up-front value from an asset that is expected to provide cash over a long period of time.
- ***Strategic Contribution Payments:*** Tobacco settlement payments for contribution to the litigation effort made in addition to the annual payments.
- ***Tobacco Company Exposure:*** The risk that the tobacco companies will be unable to make all or a portion of the tobacco settlement payments due to litigation, regulation or bankruptcy.
- ***Tobacco Settlement Agreement:*** The Agreement was executed in 1998 and settles all legal claims of 46 states and 5 territories against cigarette manufacturers in exchange for $206 billion paid over 25 years. Payments will be made in perpetuity and will change based on a number of factors, principally domestic cigarette shipment and inflation.
- ***Unadjusted Payments:*** Base tobacco settlement payments made according to a schedule in the Agreement and subject to adjustment for domestic cigarette shipments and inflation.